RECOMMENDATIONS OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

HEARINGS

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

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RECOMMENDATIONS OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

TUESDAY, FEBRUARY 1, 1983

House of Representatives,
Committee on Ways and Means,
Washington, D.C.

The committee met at 9:10 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Dan Rostenkowski (chairman of the committee) presiding.

[The press releases announcing the hearings follow:]

[Press release of Thursday, Jan. 6, 1983]

Hon. Dan Rostenkowski, Chairman, Committee on Ways and Means, Announces Full Committee and Subcommittee Hearings on Proposals To Address the Financing Problems of the Social Security System

Hon. Dan Rostenkowski (D., Ill.), Chairman of the Committee on Ways and Means, U.S. House of Representatives, today announced a series of hearings to be held by both the full Committee and the Subcommittee on Social Security to address the financing problems of the social security system.

The full Committee will begin the hearings with testimony from the National Commission on Social Security Reform on February 1 and 2, to be followed by testimony from the Administration on Feb. 3 and 4, 1983. The hearings will be held in the main committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m. each day.

Immediately following the full Committee hearings, the Subcommittee on Social Security, chaired by Hon. J. J. Pickle (D., Texas), will hear testimony from Members of Congress and the interested public who have requested to be heard. The Subcommittee hearings will be held on Monday, Feb. 7, through Friday, Feb. 11, 1983, in the main committee hearing room, 1100 Longworth House Office Building, beginning at 10 a.m. each day. Additional hearings will be scheduled at a later time, if necessary.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

Individuals and organizations interested in presenting oral testimony before the Subcommittee must submit their requests to be heard in writing no later than Wednesday, January 26, 1983, to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. Witnesses scheduled to appear will be notified by telephone as soon as possible after the filing deadline.

It is urged that persons and organizations having a common position make every effort to designate one spokesman to represent them in order for the Subcommittee to hear as many points of view as possible. Time for oral presentations will be limited with the understanding that a more detailed statement may be included in the printed record of the hearings. This process will afford more time for members to interrogate witnesses. In order to expedite the hearings, witnesses may be grouped as panelists with strict time limitations for each panelist.

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, witnesses scheduled to appear before the Subcommittee are required to submit 100 copies of their prepared statements to the full Committee office, room 1102 Longworth House Office Building, at least 24 hours in advance of their scheduled appearance.

Each statement to be presented to the Subcommittee or any written statement submitted for the printed record must contain the following information:

1. The name, full address, and capacity in which the witness will appear (as well as a telephone number where he or his designated representative may be reached).
2. A list of any clients or persons, or any organizations for whom the witness appears; and
3. A topical outline or summary of comments and recommendations.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE

Persons submitting a written statement in lieu of a personal appearance should submit at least six (6) copies of their statement by the close of business Friday, February 18, 1982, to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Washington, D.C. 20515. If those filing written statements for the record of the printed hearings wish to have their statements distributed to the press and the interested public, they may submit 100 additional copies for this purpose if provided to the Committee office during the course of the public hearings.

[Press release of Friday, Jan. 28, 1983]

HON. DAN ROSTENKOWSKI, CHAIRMAN, COMMITTEE ON WAYS AND MEANS, ANNOUNCES CHANGES IN THE SCHEDULE OF FULL COMMITTEE AND SUBCOMMITTEE HEARINGS ON PROPOSALS TO ADDRESS THE FINANCING PROBLEM OF THE SOCIAL SECURITY SYSTEM

Hon. Dan Rostenkowski (D., Ill.), Chairman of the Committee on Ways and Means, U.S. House of Representatives, today announced changes in the schedule of full committee and subcommittee hearings on proposals to address the financing problems of the social security system. The full Committee on Ways and Means will hear members of the National Commission on Social Security Reform on February 1, 1983. The Majority Leader of the House of Representatives, Hon. Jim Wright, will be the first witness on Wednesday, February 2, 1983, to be followed by Hon. Claude Pepper, Chairman of the Committee on Rules, and other members of the commission. Representatives of the Administration will be heard on Thursday, February 3, 1983. These hearings will begin at 9 a.m. each day.

The Subcommittee on Social Security will hear testimony from Members of Congress and the interested public who have requested to be heard on Friday, February 4, 1983, and Monday, February 7 through Thursday, February 10, 1983, at 9 a.m. each day. No hearing will be held on Friday, February 11, 1983.

All of the above-mentioned hearings will take place in room 1100 Longworth House Office Building, the main committee hearing room. For additional information, please refer to press release No. 1 issued earlier by the Committee on Ways and Means.

Chairman **ROSTENKOWSKI**. Good morning, ladies and gentlemen, and to the Commissioners who achieved what I consider one of the most outstanding contributions to the unity of the country in recent history, you are most welcome.

Today's hearing marks the first legislative step in the overall effort to put the social security system back on a firm financial footing. In preparing for this effort, we have been greatly assisted by the work of Alan Greenspan and his Social Security Commission, and by their success in fixing the dimensions of the system's deficit. They defused a number of alternatives long considered too explosive to handle.

Perhaps most critically, they drew together a broad bipartisan coalition behind a shortrun financing plan.

For these efforts, all of us on the committee and in the Congress commend you.

The issue has now passed to the Congress where the final package will be shaped.

While the Commission has given us a solid outline for the rest of the decade, it was unable to reach a consensus on how to close much of the deficit in the long run. I trust that Congress will have the steel to settle this question, which is of such importance to young workers who doubt the long-range health of the social security system.

Reaching a compromise on social security demands that concessions be made on all sides, both in Congress, and among special-interest groups who oppose certain alternatives. Compromise rests on the same spirit of bipartisan cooperation and purpose that prevailed on the Commission.

Mr. Conable.

Mr. CONABLE. Thank you, Mr. Chairman.

First I would like to welcome my colleagues on the Commission. Mr. Chairman, I would like to thank you for these hearings and for your promise of a fast track for social security legislation.

You are to be commended for anticipating the need in getting our committee moving in timely fashion. As we both know, there is not much time allowed us to make the constructive adjustments to continue retirement benefits past midyear. We will face certain key decisions very soon indeed.

It is appropriate that our first witnesses are members of the National Commission on Social Security Reform because their set of proposals in broad outline are designed to save the system from the crisis which confronts it.

This consensus, to which I was a party, includes a little something for everyone to dislike. But that is one of its strengths. If any one of us liked all of it, it would become immediately suspect to the others. The most important endorsements of the package come from the President and the Speaker of the House. They have provided an umbrella under which the entire Congress can stand sheltered from the rain of special interests as it perfects the consensus package.

The package is far from perfect, technically. Our committee will have to do a lot of shoring up to make it work properly. We have the resources and the capability of doing that. As we proceed unfortunately there will be forces at work to drive us apart and divert us from our goal, which must be to keep the social security system solvent.

Much may be said of the difficulties we will encounter in perfecting the package, but I do not envision any problems, however awesome they may appear at first, which we cannot resolve responsibly and equitably. The package leaves entirely in our hands a substantial part of the long-range deficit. Each of us probably has separate thoughts on that subject, but I have no doubt will be able to reach acceptable compromise on this point, too.

As of now, Mr. Chairman, two realities stand out. One, if there is any feasible and politically salable alternative to the Commission's consensus it certainly has not appeared.

Two, if the social security system truly is to be saved, it will have to be done on a bipartisan basis. If we don't do it together, it won't get done.

Thank you.

Chairman ROSTENKOWSKI. Mr. Pickle.

Mr. **Pickle**. Mr. Chairman, I thank you for recognizing me, and I want to take just a minute. I want to express my thanks to the Commission for their valuable work. The Chairman and members of the Commission have given us a broad-based package which is a good substantial beginning. Consideration of the package is proceeding, and I hope we can proceed to consider it, on a bipartisan basis.

I want to caution everyone, though, that we have a long way to go, yet, and a short time to achieve it. We must make sure the short-term package is sufficient and there may be some questions about whether in the years ahead, estimated savings are enough. We have got to forge, yet, a compromise on the long term.

I am pleased that the Commission agreed unanimously that we must take care of the long term as we solve this problem. I appreciate the chairman of our committee's enforcement of that general position.

The young worker has a right to expect this Congress to give him or her an answer for the long term. If we fail to do this, we have endangered confidence in the future of the program. This program relies on the confidence of the worker.

This is an important juncture in our Nation. Passage of a bill which gives strong and responsible solutions to both the short- and long-term problems would have a beneficial effect on the general economic climate. It would signal to the people and to the public, and to Wall Street, that the Congress can govern. Failure to do that would equally have adverse effects, and that would be devastating for social security.

I like the climate that exists at this time. I think, in that climate we can proceed progressively.

I thank all of you for your contributions.

Chairman **Rostenkowski**. Welcome again, Chairman Greenspan. The committee awaits your testimony.

STATEMENT OF ALAN GREENSPAN, CHAIRMAN, NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Mr. **Greenspan**. Thank you very much, Mr. Chairman.

Speaking for fellow Commissioners and myself, I would like to thank you and other members of the Ways and Means Committee.

The report of the National Commission on Social Security Reform, presented to the President and the Congress on January 20 would raise an estimated $168 billion for the old-age disability trust funds during calendar years 1983 through 1989. It is the judgment of the Commission that this should meet any reasonably conceivable shortfalls that could arise for the rest of this decade.

There are exceptionally adverse economic scenarios, however, which during the years immediately ahead could create temporary problems for the trust funds. Such problems, in my judgment, are appropriately addressed by the Commission recommendation of a fail-safe mechanism. This would set into motion certain changes in receipts and/or outlays which would prevent the trust funds from falling below the minimum levels required to maintain monthly benefit payments.

The Commission offers various ways in which this specific issue can be addressed, but no single recommendation is offered for its solution.

The 75-year deficit to be addressed and eliminated is judged by the Commission to be 1.8 percent of taxable payroll. We recognized, as a commission, that making judgments about the size of the deficit over such an extended period of time is subject to a rather substantial margin of error. Nonetheless, I suspect that most, if not all, of us concur that the probability that the deficit is zero and, hence, need not be addressed is exceptionally small.

Hence, the Commission agreed to a set of recommendations which would eliminate a deficit amounting to 1.8 percent of taxable payrolls through 2056.

The short-term measures to which we subscribe have a long-term deficit closing effect of 1.32 percent of taxable payroll. We agreed to additional delayed retirement credit amounting to 0.10 percent for the long-term and agreed that the remainder, 0.58 percent of taxable payroll, should be closed in one of two ways. A majority recommends it be done through an increase in the retirement age; a minority through an increase in payroll taxes. I should emphasize, however, that at least 12 members recommend that one or the other of these be chosen.

I would like to cover an issue that the Commission agreed not to address. We realized early in our deliberations that it would be very difficult for us to tackle medicare, given the short timeframe. We purposefully decided to leave the medical part of social security for the deliberations of the Advisory Council on Social Security, currently underway, which was specifically charged with reviewing the medicare program.

Nonetheless, it is important to remember, as this committee grapples with the financing of the OASDI system, that there are very significant potential problems in medicare. The financing problems, at least as now currently projected, are very large. But while OASDI and HI are two problems, they draw from one pot of revenues.

There can be little doubt that a number of financial arrangements are biasing medical costs higher than they need be. The main one being that the initiator of the scope of service, usually a physician, is rarely the person who pays the bill. Nonetheless, even where the financial and anticompetitive factors which create an inflation bias are eliminated, it is unlikely that the budgeoning growth of medical expenditures could be significantly subdued.

The reason is that, in recent years, medical and associated technologies have taken a leap forward and currently exhibit little evidence of slowing down. The advent of the artificial heart is only the leading edge. Partly as a consequence, average life expectancy has increased significantly during the past decade and is expected to continue to do so.

Any industry whose technological advances outstrip the average for the Nation as a whole will show a marked tendency to grow faster than the GNP. It is certainly not surprising that telecommunications has increased its share of GNP in recent years; neither should the share rise in medical services.

Endeavoring to suppress growth is as difficult in one as it is in the other. We cannot substantially constrain the cost of medicare unless we slow the improvement in technology, a dubious goal, or choose not to employ the technology that is currently available.

Those decisions, of course, would raise very difficult ethical and moral questions. It is important to emphasize that the solutions to medicare are very difficult and should be kept in mind as this committee focuses on the issue of retirement and disability financing systems.

I should like to address the rest of my time to the final issue which divided the Commission, the question of increasing the normal retirement age as part of the solution for the post-1990 period.

Let me say first that I do not consider the question of extending the age for full retirement benefits as a question of the appropriate level of benefits. It is a key long-term stabilization issue. Continuation of financing the old-age and survivors' insurance system through payroll taxes requires that there be rough equality in present value terms between the amount of taxes paid into the social security trust fund by each retiree and the amount that he or she ultimately withdraws.

That, as we are all aware, has not been the case in recent years. Benefits have far exceeded the combined taxes paid by individual workers and their employers plus interest over the life of their employment. It is clear, however, that if the number of years in which the average retiree receives benefits continues to increase relative to the number of years in which he contributed to the trust fund, the ratio of benefit payments to payments into the fund is almost surely going to have to fall. That is, the replacement ratio must continuously decline.

Projected over the long run, this leads to levels of monthly benefits which probably would fall far below the poverty level, ultimately.

Short of a noncredible acceleration in productivity, or massive increases in immigration over the next half century and beyond, this conclusion is numerically irresistable.

Ultimately, the age of the full retirement benefits is going to have to be linked to longevity. The longer we wait to do this, the greater the long-term pressure on the OASI trust fund. The majority of the National Commission recommends an increase in the normal retirement age, which would raise 0.6 percent of taxable payroll.

The normal retirement age would be gradually increased to 66 by the year 2015, followed in effect by indexing the longevity thereafter.

As I understand it, the major argument against the increase in the retirement age is that, despite the uncontested improvement in longevity in the past decade, there is serious question whether the ability to work has increased, as well.

As people age the number of disabled individuals must of course be expected to rise. Given a hypothetical group of individuals who in an earlier period would have died at age 65 but in the current period will live to the age of 67 or more, one must presume that a significant proportion of those whose life has been extended will be in less than perfect health, and that a significant number substantially disabled.

On the other hand, a large number of those whose life has been extended from 65 to 67 must represent individuals whose health is adequate to continue working.

As Jacob Feldman of the National Center for Health Statistics told the Commission last June, of all men between ages 65 and 67 in recent years, 63 percent were fully able-bodied with respect to work, and another 13 percent had limited work capability. Moreover, even if work disability were far more prevalent, one should not treat the issue with an old-age retirement program. It should be dealt with directly.

The OASI system should reflect what it truly was endeavored to be, a retirement system, not a disability system.

The majority of the National Commission in fact recommends generous disability benefits to those between age 65 and the increased retirement age for OASI.

This also applies to the group of individuals who have toiled in jobs requiring heavy labor throughout their lives and have great difficulty working beyond their early 60s because of the physical requirements of their occupation.

However, the number of such jobs in our economy is dwindling and will continue to do so. Hence, the number of people who retire from heavy labor will be a declining number in the decades ahead.

If this is a serious concern, it can and should be handled as a special case. One should not craft the major Government retirement system in this country to accommodate a special case.

Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Thank you, Mr. Greenspan.

Mr. Ball.

STATEMENT OF ROBERT M. BALL, FORMER COMMISSIONER OF SOCIAL SECURITY, AND MEMBER OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Mr. BALL. Mr. Chairman, as you and the committee know, this Commission was made up of 10 persons appointed by Republicans and 5 appointed by Democrats. I am the only one on the panel this morning that was appointed by Democrats, although I understand that tomorrow there will be other witnesses who are within that minority of five that served on the Commission.

But today I will be speaking for that group as well as myself. In a way not exactly characteristic of Democrats, except for the one issue of coverage of Federal employees, we maintained the same position throughout the entire study in our support of the final package and in all supplementary statements.

Mr. Kirkland made it clear at the beginning that he could not support coverage of Federal employees, but other than that all five of us are completely united.

Let me say that as a group of interrelated recommendations I fully support, and the five of us supported, with the exception noted, all the recommendations of the National Commission. There is no member of the Commission, however, who is pleased with each of the recommendations taken separately. No one would have come up with exactly these recommendations if he or she had been free to design the proposals alone. They represent a compromise within the Commission and between the Commission members and the administration.

But taken together they are in my opinion, as good a compromise as could be designed to get the widespread legislative support that is necessary to solve the social security financial problems.

In the words of the Washington Post, "It is as close to absolute fairness as any social security revision can ever be."

Given the fact that between now and 1990, social security income is estimated to fall about 5 to 10 percent short of expenditures, it is necessary to increase income or reduce expenditures to maintain the system's financial integrity.

To get agreement within the Commission, and to design a group of recommendations that could win legislative support, it was clearly necessary to do both—to have some reduction in expenditures and some increase in income.

This the plan achieves in a fair and balanced way. All share in the sacrifice necessary to restore full financial health to social security, current beneficiaries, contributing workers, employers, and the general public, but none are asked to bear a large additional burden. The changes proposed are modest and reasonable.

Taken together, the consensus recommendations eliminate the shortfall between now and 1990 and in all probability during that time we will start to build up the OASDI trust funds toward more satisfactory levels. With the addition of the agreed-upon indexing change in 1988, we can assume that the trust funds will return to satisfactory levels in the 1990s and that the recurrence of the sort of financial difficulty we are now facing will be prevented.

The agreed-upon recommendations also bring the long-term deficit of the program—as estimated in the more pessimistic of the central set of assumptions used by the board of trustees—within the range of what has traditionally been considered close actuarial balance, plus or minus 5 percent of expenditures over the 75 years for which the estimates are made. That is, the consensus recommendations reduce the official 1.8 percent of payroll deficit to 0.58 percent of payroll, which is 4.5 percent of the estimated expenditures over the next 75 years.

I would like to emphasize that, Mr. Chairman, because the major misinterpretation I have seen in many newspapers, and sometimes on television is that the Commission's proposals have succeeded only in addressing the short run. I have even seen it said they have solved the problem only up to 1990.

Well, the truth is that once you reach 1990, there are about 25 years, more even under present law, during which there is a large buildup in the trust funds, a large excess of income over outgo. The Commission's recommendations solve the short-term problem—up to 1990—then we have a long period of 20 to 25 years where even under present law there is a large excess of income over outgo, and then beyond that the consensus recommendations reduce the whole 75-year deficit down to less than 5 percent of expenditures, which has been the traditional definition of close actuarial balance.

I don't mean to rest there. This is for clarification. That is the result of the consensus recommendations.

Now, we agreed to go beyond that and to eliminate all, or approximately all, of the 0.58 percent of payroll deficit remaining. But I must say I am amazed and surprised that the testimony of the chairman put so much emphasis on the elimination of that last 0.58 percent in one special way, and that is the raising of the age at which one is first entitled to full benefits. Without that, we have reduced the deficit to a relatively small matter.

Raising the age is only one way in which one could address getting rid of the 0.58 percent. The five of us who were appointed by Democrats propose that beginning in 2010 that the law provide for an increase of less than 0.50 percent on the employer and the employee, which also eliminates this 0.58 percent. We would make the tax refundable to the worker.

Many of us have considerable doubt, Mr. Chairman, whether the need actually will arise to have that rate go into effect. The deficit occurs almost entirely 50 to 75 years from now under the estimates, but we are willing—we are urging you to put it in the law, as a matter of fact, so that the next trustees report will say that the program is fully in balance rather than just what would under the traditional approach have been to say "in close actuarial balance."

The Commission, in addition to providing for $168 billion in the short run and a reduction in the long range deficit to 0.58 in the consensus agreement, and then agreeing on two different ways to get rid of that as well, has proposed various ways of shoring up the system in the event of unlikely changes in the economy or in the demography that might cause the system to go outside what we estimate to be the most likely path. There are three of these.

We have proposed that beginning in 1988 there be a "stabilizer" in the program so that if after the proposals have built up the trust funds again, should you ever have the funds drop below 20 percent of the next year's outgo, you would automatically pay the lesser of wages or prices, rather than just prices. There is a payback in that proposal, and I don't intend to go into it in detail, but merely to remind you that we have taken note of what caused the present problem, and have proposed a way of making any reoccurrence unlikely.

Second, we are proposing that you continue the authority to borrow from hospital insurance up to the time that this stabilizer takes effect, and then finally, though we couldn't agree on the specifics, we all agreed that there ought to be an underlying ultimate fail-safe provision in the law. The five of us proposed that social security have the authority to borrow temporarily from general revenues or to issue special bonds to see the system over any very unusual short-term situation that could conceivably develop.

Mr. Chairman, I am not going to undertake in my opening remarks to go to the merits of the proposal of the group appointed by Republicans to deal with the 0.58 percent remaining deficit for the long term through raising the age of first eligibility.

We have a supplementary statement in the report. I have attached it to my statement here this morning. There is so much in the way of agreement that I feel that it is not wise for us to focus on the relatively small remaining deficit estimated to occur 50 to 75 years from now, but I do want to say just this: aside from the issue of raising the age of first eligibility, it seems to me unwise to index further changes in social security.

Under the proposal no one will know ahead of time at just what age full benefits will be available to him or her. If you do go in the direction of raising the age, which I hope you will not, it would seem wiser to leave to future Congresses the exact determination of the age at which full benefits would be payable, rather than having another provision that operates automatically way out there beyond 2015.

In conclusion, Mr. Chairman, I would like to call attention to the very first recommendation of the Commission which describes what we decided not to do, and that seems to me also to be important.

During the last few years there have been many sweeping attacks on the social security program and many radical proposals for change have been offered.

However, the Commission made its No. 1 recommendation the following:

> The members of the National Commission believe that the Congress, in its deliberations on financing proposals should not alter the fundamental structure of the Social Security program or undermine its fundamental principles.
>
> The National Commission considered, but rejected, proposals to make the Social Security program a voluntary one, or to transform it into a program under which benefits are a product exclusively of the contributions paid, or to convert it into a fully funded program, or to change it to a program under which benefits are conditioned on the showing of financial need.

I would like to conclude by complimenting our able chairman, Dr. Alan Greenspan, and to thank him for the fairness with which he conducted all the work of the Commission.

I would like also to express an appreciation to the other members of the Commission for the fine spirit of public service and cooperation exhibited by everyone and appreciation of the staff for their excellent work.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF ROBERT M. BALL, MEMBER, NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Mr. Chairman and members of the committee: My name is Robert Ball. From April 1962 until March 1973, I was Commissioner of Social Security, serving under Presidents Kennedy, Johnson, and Nixon. Prior to becoming Commissioner, I served for approximately 20 years in various positions in the Social Security Administration and its predecessor organization, the Social Security Board, and for the 10 years prior to becoming Commissioner, I was the top civil servant in the social security organization. Since leaving the government, I have continued my deep interest in social security and have written and lectured extensively on the subject. I am currently a Visiting Scholar at the Center for the Study of Social Policy, Senior Consultant to the Study Group on Social Security, and a member of the Executive Committee of the Save Our Security (SOS) Coalition. I am appearing today, however, as one of Speaker O'Neill's appointees to the National Commission on Social Security Reform and the views in my testimony do not necessarily represent those of any other organization with which I am associated.

INTRODUCTION AND SUMMARY OF POSITION

Taken as a group of inter-related recommendations, I fully support the consensus recommendations of the National Commission on Social Security Reform. The recommendations are supported by all five of the Commission members who were appointed by Democrats [1] and 7 out of 10 of those appointed by Republicans. As you know, the proposals have been endorsed by the President and the Speaker of the House.

There is no member of the Commission who is pleased with each of the recommendations taken separately. No one would have come up with exactly these recommendations if he or she had been free to design the proposals alone. They represent a compromise within the Commission and between the Commission members and the Administration, but, taken together, they are, in my opinion, as good a compromise as could be designed to get the widespread legislative support that is necessary to solve the social security financial problems. In the words of the Washington Post, "It is as close to absolute fairness as any social security revision can ever be."

Given the fact that between now and 1990, social security income is estimated to fall about 5 to 10 percent short of expenditures, it is necessary to increase income or reduce expenditures to maintain the system's financial integrity. To get agreement within the Commission and to design a group of recommendations that could win legislative support, it was clearly necessary to do both—to have some reduction in expenditures and some increase in income. This the plan achieves in a fair and balanced way. All share in the sacrifice necessary to restore full financial health to social security—current beneficiaries, contributing workers, employers and the general public, but none are asked to bear a large additional burden. The changes proposed are modest and reasonable.

Taken together, the consensus recommendations eliminate the shortfall between now and 1990 and in all probability, during that time, will start to build up the OASDI trust funds toward more satisfactory levels, and according to the more pessimistic of the intermediate estimates (II)-B), the trust funds will return to fully satisfactory levels in the 1990's. The agreed-upon recommendations also bring the long-term deficit of the program, as estimated in II-B, within the range of what has traditionally been considered close actuarial balance, plus or minus 5 percent of expenditures over the 75-years for which the estimates are made. That is, the consensus recommendations reduce the official 1.8 percent of payroll deficit to 0.58 percent of payroll which is 4.5 percent of the estimated expenditures over the next 75 years. The consensus was, however, that we would go further and propose ways of reducing the 0.58 percent of payroll deficit to approximately 0. We could not agree on how best to eliminate this final 0.58 percent but the five members who were Democrats have proposed one plan and other members of the Commission another.

In addition to a temporary change in the indexing procedure to take effect in 1988 should the trust funds be drawn down to unacceptable levels, the Commission agreed that authority for old-age, survivors and disability insurance to borrow from the hospital insurance fund would be continued as a fail/safe procedure until 1988. The Commission also agreed that the law should contain a provision that would ensure timely payment of benefits if unexpectedly adverse conditions occurred with little advance notice. The Commission could not agree on the specifics of this ultimate fail/safe, but the five members who were appointed by Democrats recommend that the law be amended go allow short-term borrowing from the general fund at interest in the unlikely event that the other measures recommeded proved insufficient in some emergency situation.

All in all then, the proposals of the Commission solve both the short- and long-term financing problems of the program.

THE DEFINITION OF SHORT-TERM AND LONG-TERM FINANCIAL GOALS

The Commission decided early in its deliberations not to deal specifically with the Medicare program. The current Advisory Council on Social Security named by Secretary Schweiker will be concerned exclusively with making recommendations about Medicare and its future solvency. Although the official cost estimates show the possibility of financial difficulty for the hospital insurance program by the latter part of this decade or early in the next, we did not feel that we could adequately deal with both hospital insurance financing and the financing of old-age, survivors and disability insurance (OASDI) in the time available. Moreover, the considerations involved in hospital insurance financing are entirely different than those involved in the cash benefit program. The increasing costs of hospital insurance under Medicare are driven by the same factors in medical economics that are also driving up the cost of private insurance, and many of us felt that in this program the proper emphasis was not merely to increase the funds or reduce benefits to conform to future actuarial projections, but rather to consider the extent to which the rate of increase in the cost of providing services can be controlled. The entire report of the Commission and its recommendations relate to OASI and DI.

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[1] Mr. Kirkland dissented from the coverage of new Federal employees and instead proposed taxing the entire employer payroll.

Short term

Under present law there is a shortfall in expected income for OASDI as compared to expected expenditures between now and 1990. The gap is not large relative to the size of the program—5 to 10 percent—but it is real and must be addressed. The boundaries of the shortfall would appear to be between $75 and $200 billion, depending upon the economic assumptions used. The Commission rather quickly agreed that since trust fund balances for OASDI were practically nonexistent that it was only prudent to set short-run goals on the basis of pessimistic economic assumptions. We are not necessarily convinced that there is a shortfall between income and expenditures in the range of $150 to $200 billion as has been publicized; we are convinced that it could be this high under adverse economic conditions and, moreover, should the economy perform better than is assumed in the pessimistic assumptions, the resulting more rapid build-up in trust fund balances would be desirable.

Mid-term

The shortfall between now and 1990 is followed by a period of 20 to 25 years when OASDI, even under present law, will have a substantial surplus of income over outgo with the trust funds rather quickly building to adequate levels. Although it is possible to construct economic projections where this build-up would not happen under present law, the Commission's recommendation to—beginning in 1988—shift to wages or prices whichever is the lower should the trust funds drop below 20 percent of the next year's outgo would go a very long way toward guaranteeing that the expected build-up in the 1990's and the early part of the next century will occur. Basically, the reason for the favorable period from roughly 1990 to 2015 is demographic. Birth rates were low in the great depression years of the 1930's with the consequence that the increase in the numbers of older people which we have been experiencing will slow down. In addition, the baby-boom generation born after World War II will be swelling the labor force so that the ratio of workers to beneficiaries is expected to stay about the same as it is today, three workers for each beneficiary, for at least the next 30 years. Under these circumstances, increases in productivity *reduce* the cost of social security measured as a percent of payroll or gross national product. At the same time the present law already provides for an increase in the contribution rate beginning in 1990, with the result that very large annual excesses of income over outgo are projected for a considerable period of time after 1990. In the one year, 1991, the excess is expected to be over $20 billion, and this figure will grow year by year.

Long-term

The Commission also agreed that the estimated long-range deficit of 1.8 percent of payroll should be reduced to approximately zero. We differed among ourselves as to why we took this position. Personally, I have considerable skepticism about our ability to know within very wide limits what the demographic, economic, and social situation of the United States will be 50 to 75 years from now, and the projected deficit occurs almost entirely in that far-off period. However, as a matter of restoring confidence in the financing of the program, it seemed best to all of us to design a plan that would result in the Board of Trustees saying officially that the program was in full actuarial balance in both the short and long run. The consensus agreement alone and without further addition comes very close to this goal, providing for a reduction of 1.22 percentage points in the 1.8 deficit. The five members of the Commission who were appointed by Democrats proposed, in addition, that the law be amended to provide a contribution rate increase of 0.46 percent of payroll in the year 2010 (refundable to the employee) as a way of eliminating the remaining 0.58 percent of the long-term deficit. Such an increase may not actually be needed and, of course, as 2010 approaches such an increase would not be allowed to go into effect unless estimates then being made showed that it was desirable. Moreover, by that time there might be support for some other way of financing part of the social security program. Yet to put the increase in the law now is to show the intent of Congress that the full estimated deficit would be eliminated. The proposal made by other members of the Commission to meet this remaining 0.58 percent deficit would be to raise the age of first eligibility for full benefits to 66 by 2015 and then after that date have the age rise automatically in accordance with increases in longevity, ultimately reaching 68 in about 2055 under the assumptions in the trustees' report.

Mr. Chairman, we have agreed to so much within the Commission—a plan to meet the short-run problem, and a plan to meet by far the largest part of the estimated long-run deficit that I hesitate to spend much time on this difference of opinion about two approaches to a problem which may well not exist at all. The five members of the Commission who were appointed by Democrats have included a supplementary statement in the Commission report that says why we are against raising the age of eligibility for full benefits and I have attached that supplementary statement to this testimony. Suffice it to say here that aside from the issue of raising the age of first eligibility, it seems to me unwise to index further changes in social security. Under the proposal, no one can know ahead of time at just what age full benefits will be available to him or her. It would seem wiser to leave such determinations to future Congresses.

THE CONSENSUS AGREEMENT

The major provisions affecting the financing of the program are as follows:

Rescheduling the social security tax rate

Under present law, the OASDI tax rate rises from the 5.4 percent of earnings now being charged to 5.7 in 1985 and to 6.2 in 1990. Under the agreed-upon plan, workers would not have to pay any more than under present law until 1988 and then there would be a higher rate for two years, an increase of 0.36 percentage points in 1988 and 1989, with a return to the present schedule in 1990. (The OASDI trust funds would get additional income from moving the 1985 rate to 1984, but the increased social security tax for workers would be exactly offset in that year by a refundable tax credit.) Employers, who can count the social security tax as a business expense, would be charged 0.3 percentage points more than present law in 1984 and as is the case with employees, 0.36 percentage points more in 1988 and 1989.

Although this rescheduling of tax rates contributes $40 billion to the short-term goal of $150 to $200 billion, the increase for individuals is relatively slight—nothing until 1988 and then, for example, for a $20,000 earner, $1.38 per week for two years.

Putting the social security tax for the self-employed on a basis comparable to other covered workers

When the self-employed were first brought under social security, the rate for them was established at 1½ times the employee rate, and although it has varied somewhat from that basic rate from time to time, it is approximately at that level today and under present law would soon be 1½ times the employee rate again. They, of course, get the same protection as everyone else under the system, but for others the rate paid is the employee rate plus a matching amount by the employer. Thus everyone under the system pays somewhat more than would be the case if the self-employed paid what is being paid by and on behalf of employees. This isn't fair. The proposal is to charge the self-employed two times the employee rate and to treat one-half of it as the employer's contribution is treated—allowing the self-employed to deduct one-half of their total contribution as a business expense. This proposal will increase income to the social security system between now and 1990 by $18 billion, but $12 billion will be offset in the general budget by allowing the self-employed to take one-half of the combined tax as a business deduction. This change also reduces the long-term, 75-year average, estimated deficit by 0.19 percent of payroll.

Crediting the trust funds for past military service credits and unnegotiated checks

Employers and employees have to pay for socal security benefit credits when they are earned, but in the case of certain military service credits that are paid for by the Federal government the amounts due are not paid until the benefits are paid. Putting payment for military service credits on a basis more comparable to other benefit credits and recrediting to the trust funds outstanding checks which have gone uncashed for a considerable period of time would mean that the OASDI trust funds would be credited with about $20 billion in 1983.

The military have been covered under social security for many years but they pay contributions only on the cash paid to them. The government pays the cost of the benefit credits made in lieu of allowances for room and board. However under present law, the government does not make payment currently (but only when benefits are paid) for these credits. Moreover prior to 1957, free credits of $160 per month were granted for service in the Armed Forces and these credits too are paid only when benefits are paid, and the cost is amortized over a long period of time. The proposal is to pay up for the back amounts owed by the government now in a lump sum and then in the future to pay currently the equivalent of employer and employee contributions on the wage credits in lieu of allowances.

Mandatory coverage of remaining nonprofit employees (15 percent) and Federal employees newly hired after 1983

Social security is a system with a national purpose through which just about everyone who works contributes toward the payment of benefits to make up for income lost because of retirement in old age, total disability or the death of a wage earner in the family. It is anomalous that Federal employees do not take part in this national effort.

The Commission recommends mandatory coverage of newly hired employees and establishment within the civil service retirement system of a special supplementary plan for these newly hired employees, independent and completely separate from social security in every way, just as private pension plans are supplementary to social security and separate from it. Present civilian employees of the Federal government (the military are already covered under social security) would continue to be covered only by the civil service retirement system for their employment by the Federal government.

For many new Federal employees, this arrangement of social security plus a supplementary plan would undoubtedly be better than what would otherwise be available to them. Social security with its weighted benefit formula is generally better than the civil service retirement system for low-paid employees, and frequently better for those who move in and out of Federal government. Full survivorship and disability protection is more quickly achieved under social security. The supplementary plan should be designed so that when combined with social security it will supply, overall, for most people as good protection as the present civil service system does alone.

Covering those non-profit employees not now covered (15 percent) and newly hired Federal employees will add $20 billion income to the social security system between now and 1990. Moreover it will reduce the long-range deficit in social security by $\frac{3}{10}$ths of a percent of payroll. This is true because today, while about 80 percent of Federal annuitants are also eligible for social secuity when they reach 65, they will have paid into social security for relatively short periods and receive benefits that are excessive in relation to the contributions that they have made. Everyone else in the country is paying somewhat higher social security contribution rates because Federal employees are not covered.

One think that present Federal retirees and present Federal employees would not have much standing in arguing the case against the coverage of new Federal employees, but they have been arguing that (1) new Federal employees will be asked to "bail out" the social security system to their own disadvantage, and (2) present retirees and present employees will be hurt because the new employees will not be paying into the civil service retirement system or not paying in as much as they otherwise would. Both of these arguments are fallacious. Under the plan, new employees will be asked to do just what all other employees in the country are asked to do, pay into social security and get social security benefits. Then, in addition, they will share with about half of the private labor force the additional protection of an independent, supplementary plan. Far from "bailing out" social security, this arrangement will end the situation under which Federal employees now get social security benefits at bargain rates. Secondly, it just is not true that the present civil service retirement system will be less well financed because of the proposal. At the present time, the protection furnished by the civil service retirement system is worth about 40 percent of payroll. Employees are paying 7 percent of their earnings toward this protection but in the future benefits will be paid for mostly from general revenues. The contributions of newly hired people toward their specially designed benefit provisions within the civil service retirement system will be mingled with all other contributions to that system, which today is not a single plan and will not be in the future. Today the system covers, with special provisions, members of Congress and congressional employees, air controllers etc., as well as the bulk of executive branch employees. The lower contributions to be paid by new employees (because, of course, the supplementary plan on top of social security will be cheaper than the design of the present plan for the presently employed) will be exactly balanced by the fact that the newly designed plan will have lower long-term costs. The civil service retirement system as a whole will not be injured. There is apparently widespread misunderstanding among Federal employees about these facts, some even believing that the system is adequately financed by a combination of the 7 percent contributions that they pay with matching contributions from their agency. It is important that these misunderstandings be corrected.

Delaying the cost-of-living adjustment for 6 months so that in the future any automatic increases will be made for the month of December rather than for June as in present law

The five members of the Commission who are appointed by Democrats agreed to this change with great reluctance. We did so because it was essential to the agreement. The agreement does not include any other reductions in present or future benefits—no reduction in replacement rates or cuts disguised as increases in the age at which full benefits are first paid, although one-half the benefit of the 10 percent of beneficiaries with the highest incomes would be subject to income tax under the agreement. It looks now as if the automatic increase in benefits due to the cost-of-living adjustment payable for this June under present law will be about 4 percent. This is an increase for the average retired beneficiary from the current monthly benefit of about $420 to a new rate of about $437. Under the plan, the new rate of $437 for the average retired beneficiary would be delayed until the payment for the month of December. Moving the cost-of-living adjustment to the calendar year basis will reduce expenditures about $40 billion between now and 1990 and reduce the long-range deficit by 0.27 percentage points.

Under the agreement, those social security beneficiaries who also get Supplemental Security Income because their benefits and other income are too low to meet minimum standards of need will have their SSI benefits raised by $30 a month. In the future, $50 of social security benefits will not be taken into account in determining need under the SSI program instead of $20 as at present. The agreement did not cover the question of whether the cost-of-living adjustment for the SSI program should be advanced six months from present law and the Administration has now proposed this as part of its new budget proposal. I hope that the Congress will not agree to any delay in the cost-of-living adjustment for means-tested programs, in spite of our reluctant agreement to a delay in the case of social security.

Income taxation of one-half of social security benefits of higher income beneficiaries

Social security benefits are not now subject to income taxation because in the early days of the program the Treasury ruled that social security benefits are a gratuity. On the basis of this ruling, over the years social security payments have been treated differently than other retirement income. The rule generally for retirement income is that it is subject to income taxation once the recipient has recovered what he has paid toward the retirement benefit, exclusive of interest. Thus employer paid-for pensions are subject to income taxation immediately and in full, and contributory plans such as Federal civil service are taxed after the benefits exceed the employee's own contribution. The special treatment of social security benefits hardly seems justified for higher income beneficiaries. Thus we are proposing that for single filing units with $20,000 or more in non-social security income and for those filing as couples with $25,000 or more (10 percent of beneficiaries) one-half the social security benefit be taxable. The limitation to one-half rests on the rationale that although one-half the benefit can be thought of as being derived from the employee contribution on which a tax has been paid during one's working life, the other half, derived from the employer contribution, has not been taxed. It has not been taxable to the employee and is treated as a business deduction by the employer.

The Commission recognized that this proposal needs refinement to eliminate triggering the taxation of a sizeable amount of social security income by having other income just barely over the threshholds recommended. One possible way of meeting this problem would be to include in taxable income $1 of social security benefits for each $2 of non-social security income above the threshholds, but the Committee will undoubtedly want to study other possibilities. This proposal results in additional income to the system of $30 billion between now and 1990 and reduces the long-range deficit by 0.6 percent of payroll.

Measures to protect the future financial stability of the program

The short-term financing problem in social security is entirely due to recent economic performance. The present program is very sensitive to changing economic conditions, particularly the relationship of wages and prices. Income varies according to the level of payrolls while benefits rise with increases in the consumer price index. Usually wages rise faster than prices, and the resulting higher payrolls finance the more slowly rising cost-of-living increases. This is how the pay-as-you-go financing of the system ordinarily works. In recent years, however, prices rose faster than wages, causing larger pay-out and lower income than expected. In addition, high unemployment has further reduced payrolls. As part of the agreed-upon package, the Commission proposes that (after the increases income for 1988 is count-ed and reserves are expected to have risen to more adequate levels) if ever again the OASDI reserves drop below 20 percent of the next year's outgo, wages or prices, whichever is the lower, would be paid until the 20 percent fund ratio was restored. When the fund ratio reached 32 percent, additional benefits would be paid to make up for any payments that were less than the increases called for by the price adjustment. The pay-back would be limited to amounts that would maintain a 32 percent fund ratio.

In addition to this modification of indexing which would help stabilize the program in relation to economic factors, the consensus agreement includes an extension of the authority of the OASDI trust funds to borrow from the hospital insurance funds between now and when this "stabilizer" becomes effective. It is not expected that either of these devices will be needed under the plan, but it is important to have insurance against the possibility of even more pessimistic economic performance than is assumed in the pessimistic assumptions underlying the basic recommendations.

The Commission has gone even further and recommended that beyond the stabilizer and inter-fund borrowing, there should be an ultimate fail/safe arrangement to tide the program over some completely unexpected short-term development. We were unable to agree on the exact nature of such a provision but, as indicated earlier, the five members of the Commission appointed by Democrats recommended that authority be granted to the program under such limited circumstances to borrow from general revenues at interest, or if it is considered preferable to issue its own bonds which would clearly indicate that the debt was a social security obligation.

Other proposals that either have no financial effect or relatively small financial effect

The Commission has made several other proposals, many unanimously, which are important even though most do not contribute significantly to the solving of the financial difficulty. They include prohibiting the withdrawal of state and local government employees, the great majority of whom are now covered under social security through voluntary agreements, the elimination of windfall benefits for persons with pensions from non-covered employment, several proposals for providing greater equity under the program for certain groups (primarily women), the gradual increase from 3 percent to 8 percent (after 1990) for each year in which the individual postpones benefits because of work, the reallocation of the amount of the social security tax now going to the OASDI and the DI trust funds, the elimination of opting out of part of social security coverage through the use of a salary reduction plan (section 401(k) of the Internal Revenue Code), new investment procedures for the trust funds which will make clear that the investments are being properly handled, and the addition of two public members to the boards of trustees. I support all of these proposals and their rationale is adequately in the report itself.

The removal of social security from the unified budget and the establishment of the Social Security Administration as an independent agency under a bipartisan board

Although the majority of the Commission favored taking the social security program out of the unified budget and treating its financing entirely separate, as was the case prior to fiscal year 1969, the division of opinion was fairly close. There was more general agreement on setting up social security as an independent agency although some members felt that more study was required before action was taken. My own belief is that both of these actions would help restore faith in the fiscal integrity of the social security system and would improve the operation of the program.

It is my understanding that the Administration has agreed that the OASDI program will be presented in the budget from now on as a separate budget function and not be included in the 600 function with other income programs. I believe this to be an important step in the right direction, and even though this change could not be implemented in time for the current budget, it is my understanding that there is every intention to treat OASDI as if it were a separate function in this budget too.

CONCLUSION

There is one recommendation of the Commission that I have not yet commented on, and, which, in some ways, may be the most important recommendation of all. The last few years have seen sweeping attacks on the social security program and many radical proposals for change have been offered. However the Commission made its #1 recommendation the following:

"(1) The members of the National Commission believe that the Congress, in its deliberations on financing proposals, should not alter the fundamental structure of the Social Security program or undermine its fundamental principles. The National Commission considered, but rejected, proposals to make the Social Security program a voluntary one, or to transform it into a program under which benefits are a product exclusively of the contributions paid, or to convert it into a fully-funded program, or to change it to a program under which benefits are conditioned on the showing of financial need."

I would like to conclude by complimenting our able chairman, Dr. Alan Greenspan, and to thank him for the fairness with which he conducted all the work of the Commission. I would like to express appreciation to the other members of the Commission for the fine spirit of cooperation exhibited by everyone and to the staff for their excellent work.

[Attachment No. 1]

SUPPLEMENTARY STATEMENT BY COMMISSIONERS ROBERT M. BALL, MARTHA KEYS, LANE KIRKLAND, DANIEL PATRICK MOYNIHAN, AND CLAUDE PEPPER (MEMBERS SELECTED BY THE DEMOCRATIC LEADERSHIP OF THE CONGRESS)

LONG-TERM FINANCING AND ISSUES OF SPECIAL CONCERN TO WOMEN

Meeting the Remaining Long-Term Deficit

All of us supported the compromise agreement which is being recommended by a vote of 12 to 3 of the full Commission.[1] The agreement provides for fully meeting the Commission's short-term financing goal and also for meeting about two-thirds of the Commission's long-term goal—1.22 percent of payroll out of the 1.8 percent projected need.

We recommend that the remaining 0.58 percent of payroll deficit be met by providing additional revenues starting in the year 2010, in advance of the period when the bulk of the deficit is projected to occur. Sufficient additional revenues would be provided by an increase of less than one-half of 1 percent (0.46 percent) in deductions from workers' earnings beginning in 2010 and a like amount in employer payroll taxes (with an equal combined rate for the self-employed) or the revenue could be supplied by an equivalent general revenue contribution, or some combination of the two. For purposes of present legislation we would support putting in the law now an increase in contribution rate beginning in 2010 of 0.46 percent of payroll (with the employee contribution offset by a refundable income tax credit) recognizing, of course, that in the next century the Congress may prefer to raise the money in some other way and that, in fact, such a rate increase would not be allowed to go into effect unless estimates at the time of the scheduled increase showed that it would be needed.

An increase of less than one-half of 1 percent in the contribution rates in all probability would not mean an increase in the burden of supporting OASDI because: (1) By 2010, real wages are likely to be substantially higher than they are now; and, (2) although levied at a higher rate, the rate will apply to a smaller portion of total compensation than today if the expansion of non-taxable fringe benefits projected in the estimates actually occurs. (If such expansion fails to materialize the contribution rate increase would be unnecessary.)

In contrast to our plan for meeting the part of the long-range deficit not addressed by the compromise agreement, some members of the Commission seek to meet the remaining deficit by raising the age at which full benefits are first payable and then continuing to raise the age automatically in relation to improvements in longevity. This proposal is a benefit cut. If the age is raised to 68, benefits would be reduced by 20 percent relative to those received at age 65; if it is raised to age 67, the cut is 13 percent; and if set at age 66, the cut is 7 percent.

The cut would be concentrated on those unable to work up to the newly set higher age and on those unable to find jobs. It would cut protection for those now young, the very group being asked to pay in more and for a longer period of time. And an automatic provision changing the age of first eligibility for full benefits would make it very difficult for people to plan for retirement. It would also greatly complicate private pension planning. In our opinion it is unwise to try to index Social Security for all possible future changes in society. Social Security has enough indexing. Congress can act to make future changes in the long-run future as needed.

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[1] Mr. Kirkland is not joining in the recommendation to extend coverage to Federal employees and has filed a supplemental statement on the issue.

We favor the maintenance of the full range of retirement options in present law so that the program will be responsive to the great variety of occupations in the American economy and to the great variety of individual circumstances. It is one thing for example, to consider a higher age of first eligibility for full benefits for white collar workers; something else again for those required to do heavy work. The system today has the required flexibility. It provides: (1) full benefits at any age for qualified workers who have long continued total disability, (2) actuarially reduced benefits for those who apply between ages 62 and 65, (3) higher benefits for those who postpone retirement and continue to work between 65 and 70 (3 percent a year additional benefits under present law, to be raised to 8 percent during the 1990's under the Commission recommendations).

Some have argued for raising the age at which full benefits are first payable on the ground that as life expectancy increases, so will the ability to work. However two leading government authorities on health and the aging testified before the Commission that data on increased longevity carry no evidence that health improved commensurately. If anything, they said, what evidence there is indicates the contrary; more people living longer, but with more chronic illness and impairments. Moreover, recent increases in longevity may be related to retirement at earlier ages.

It is, of course, highly uncertain what the economy and the labor market will look like in the next century. Two major possibilities exist. A labor shortage may result from projected shrinkage of the proportion of persons in the 20–64 age group.[2] In that event, greater market demand for the services of older people would produce greater paid-work opportunities for them. Employers would be seeking older people and the benefit increase for work after 65 recommended by the Commission would encourage older people to work. If, on the other hand, a labor shortage does not materialize, raising the age of first eligibility for full Social Security benefits would force a large number of elderly persons into early retirement with lower benefits than current law provides.

We should not cut benefits in an attempt to keep older persons at work. Instead we should recognize and remove the impediments that stand between older workers and employment. Most important of all, economic arrangements should favor full employment and, then, the voluntary approach—the incentives prepared by the Commission—will have a chance to work. Social Security benefits are not so large as to cancel the lure of good wages. The best medicine for Social Security is full employment and economic growth, not benefit cuts.

Meeting Problems of Special Concern to Women

Since enactment of the Civil Rights Act of 1964, Federal law has sought to prevent and redress unequal treatment of women. Despite those efforts, substantial inequalities persist and much remains to be done.

In general, gender-based discrimination has been eliminated from the OASDI program through legislative change and court decisions, but in recent years there has been a growing concern regarding the extent to which the Social Security system has adapted to the changed roles of women in society and the economy. The labor force participation rate for married women has almost doubled in the last 25 years. Over 65 percent of all women aged 20 to 54 are now in the labor force. In addition, the divorce rate has increased significantly. Two decades ago, there was one divorce for every four marriages; in 1976 that rate had risen to one divorce for every two marriages.

Although the scope and urgency of economic considerations appropriately consumed most of the time of the Commission, it did give attention to some of the problems that currently exist for women in Social Security coverage. Four specific recommendations were made for important changes affecting certain groups of widows, divorced women and disabled women.

Social Security has indeed given extensive protection to women and men. It provides benefits for 91 percent of women over 65 today (compared to 10 percent of women who received benefits from a private pension system in 1980). Nevertheless, the significant changes in women's roles in society and the economy have caused many inequities and unintended results for women beneficiaries.

Today, the majority (65 percent) of working age women are in the labor force; yet their benefits may be greatly reduced if they leave the labor force for a period of time for homemaking or child-caring. Also lower family retirement and survivor benefit exist for 2 for wage-earner couples than for 1 wage-earner couples with the same family earnings history (although there are some advantages to having benefits based on one's earnings that are partly offsetting).

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[2] A labor shortage would result only if the relative reduction in the working age population were not offset by productivity improvements.

Homemakers have no individual coverage or eligibility to Social Security and no credits of their own on which to build with later employment because of early widowhood or any other reason. Divorced women may be severely affected by the arbitrary 10-year duration-of-marriage requirement and the inadequacy of the 50% dependent benfit for thier independent economic needs. Currently, the benefit for the divorced woman depends upon the actual retirement of the former spouse; however, the Commission has recommended a change which will correct this problem. Disability protection exists only for women who remain quite continuously in the labor force and not at all for homemakers. It is often lost to working women during a period of time spent in the home.

Since the introduction in 1976 by Representative Martha Keys and Representative Don Fraser of legislation to implement the concept of earnings sharing, many have believed this to be the best solution to these anomalies. Earnings sharing is a recognition of marriage as an economic partnership with equal respect given to the division of labor chosen by each couple. It accords the right of each individual to a retirement income based on half of the total retirement credits earned by the couple during their marriage. This is similar in concept to the sharing of income in the joint tax return of a married couple. Working women would have a continuous record of Social Security credits when they retire instead of zero credits for years spent in the home. It would respond to, and recognize, the economic value to the couple of full-time work in the home by either spouse.

Earnings sharing has been proposed in many forms and was recommended for consideration by both the 1979 Advisory Council on Social Security and the 1980 President's Commission on Pension Policy. Obviously, such a comprehensive change in structure requires careful development of a detailed proposal and thorough analysis of its impact. There are many technical and administrative questions to be worked out and special consideration must be given to continued strong protection for the family against death or disablement of its primary wage-earner. These are not insurmountable problems, however. We believe that earnings sharing is the most promising approach to the solution of Social Security problems of special concern to women and we urge renewed efforts to develop a comprehensive proposal based on this concept.

[Attachment No. 2]

TABLE A.—SHORT-RANGE AND LONG-RANGE COST ANALYSIS OF OASDI PROPOSALS

Proposal	Short-term savings, 1983–89 (billions)	Long-range savings (percentage of payroll)
Cover nonprofit and new Federal employees [1]	+20.0	+.30
Prohibit withdrawal of State and local government employees	+3.0	
Taxation of benefits for higher income persons	+30.0	+.60
Shift COLA's to calendar-year basis	+40.0	+.27
Eliminate windfall benefits for persons with pensions from noncovered employment	+.2	+.01
Continue benefits on remarriage for disabled widow(er)s and for divorced widow(er)s	−.1	
Index deferred widow(er)'s benefits based on wages (instead of CPI)	−.2	−.05
Permit divorced aged spouse to receive benefits when husband is eligible to receive benefits	−.1	−.01
Increase benefit rate for disabled widow(er)s aged 50 to 59 to 71½ percent of primary benefit	−1.0	−.01
Revise tax rate schedule	+40.0	+.02
Revise tax basis for self-employed	+18.0	+.19
Reallocate OASDI tax rate between OASI and DI		
Allow interfund borrowing from HI by OASDI		
Credit the OASDI trust funds, by a lump-sum payment for cost of gratuitous military service wage credits and past unnegotiated checks	+18.0	
Base automatic benefit increases on lower of CPI or wage increases after 1987 if fund ratio is under 20 percent, with catch-up if fund ratio exceeds 32 percent		
Increase delayed retirement credit from 3 percent per year to 8 percent, beginning in 1990 and reaching 8 percent in 2010		[2]−.10
Additional long-range changes [3]		+.58
Total effect	+168.0	+1.80

[1] Includes effect of revised tax schedule.

[2] This cost estimate assumes that retirement patterns would be only slightly affected by this change. If this change does result in significant changes in retirement behavior over time, the cost increase would be less (or possibly even a small savings could result).

[3] Alternate methods for obtaining this long-range savings are presented in the additional statements of the members (in ch. 4).

Note.—See text for complete description of the proposals.

Chairman ROSTENKOWSKI. Thank you, Mr. Ball. It is always a pleasure to welcome a former member not only of the Congress, but a member of the Committee on Ways and Means who made a great contribution while serving on this side of the desk.

Joe, it is nice to have you with us. The committee is ready to receive your testimony.

STATEMENT OF JOE D. WAGGONNER, JR., FORMER MEMBER OF CONGRESS FROM THE STATE OF LOUISIANA, AND MEMBER OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Mr. WAGGONNER. Thank you, Mr. Chairman. I want to thank you and the other members of the committee to allow me the opportunity to come and visit with you again. I am somewhat reluctant to appear on this side of the table because it does represent the first opportunity I have been privileged to do this since leaving this great institution.

If I ever have a love or a committee, of course, it will be for this committee because it is here that we do find the bedrock of America because you do determine, as you have in the years gone by, what the future of this great land is going to be.

Ways and Means, of course, will always be my first love. I love and respect each and every one of you.

I must call to your attention something that Mr. Ball has just said. He pointed out to you, Mr. Chairman, that the Commission was composed of 10 appointed by Republicans and 5 appointed by Democrats.

That, technically, is so, but I happen to be a Democrat appointed by a Republican President and I am proud of that opportunity. Seven members of the Commission are Democrats.

I would remind Mr. Ball that while at least for a while as Commissioner of Social Security, he was appointed to serve this great land by a Republican President himself. I don't think this has anything to do with our bipartisan effort.

I didn't know that this Commission was ever intended to be anything but bipartisan.

I was, am, and will remain a Democrat. I am proud of that.

I am not here to kill you with rhetoric today. I don't intend to do that. I have no prepared statement.

I found myself, at the conclusion of the Commission's report, without staff, and I had to go back to work and do something for myself and write a dissent and I sure had to find somebody to type my dissent in this particular instance, but it was good for me to get back into nitty-gritty work again and in this particular instance I enjoyed it.

By now what is to be done with this Commission report is yours. The Commission advisory perhaps was misunderstood by some and I, first of all, misunderstood the Commission itself. I thought at the outset, and I read just last night the Executive order, the charter which was given to us and I concluded that we were members of the Commission to recommend to the President, to you, Health and

Human Resources, what we thought should be done to help the problem that exists with our social security program.

Somewhere along the way we lost our target. We lost our mission.

We became a third party mediator between the President and the Speaker. It really became just exactly that.

I think we made a mistake. I think we failed to accept the challenge which was ours when we became politicians. I was and I still am a politician; I accept that and I am proud of that, too.

Political life can be, and by and large is an honorable profession, but we were attempting to mediate imagined differences between other people.

We had to make speculative political judgments and I think we were wrong.

Now, you know I have always said through the years, others still say, you have heard me say in years ago when I was here, when something wasn't broke, don't fix it. Let me tell you something; social security is broke, but you can't fix it with what the Commission has recommended to you.

You can't fix it if you believe what I personally believe, social security ought to be and I don't ask you to agree with what I believe social security ought to be. You might be right, and I might be wrong, but surely you will still give me the credit for believing that I am right and I do believe that I am right.

I believe that social security still must be a supplemental program. Social security must have additional tools for people for future generations of Americans.

But this Social Security Commission came into being for one simple reason and I hope Mr. Ball will remember what I am saying now. I said it during the course of your Commission, that the only reason this Commission exists today simply stems from the fact that previous assumptions about the future stability of social security was based upon faulty, overly optimistic economic assumptions and because those economic assumptions were overly optimistic and turned out to be wrong, we are here now saying we have got to try to correct those mistakes.

I am saying to you that these Commission recommendations are overly optimistic.

In the short range, you will be lucky, very, very lucky, if we get by with these recommendations through the short range, through 1989, and only then will we—I am still a part of this great land and proud to be—if our economy performs, or resumes performing. This economy is not performing now. It has belatedly, slowly, begun to react and I am telling you this delay is trickling over to the long range.

There is, if the economy performs, some chance in the short range that these recommendations will get it as many dollars, as projected, but never, ever can the overly optimistic recommendations in the long range perform and do something in the long range to stabilize social security.

You only have four fundamental options whether you share my philosophy about social security or not.

Three of them are unacceptable to me. Those three options which are unacceptable to me are, first, to accelerate or to increase the social security payroll taxes.

No. 2, you can finance, or attempt to finance, social security with Treasury supplemental financing. That, too, is unacceptable to me. Perhaps to you.

Again, you might not share my philosophy.

No. 3, you can mix unrelated taxes or Treasury financing. What you really have in this Commission recommendation is a mixture of these three options.

The fourth is the viable option from my point of view and that viable option, if you want a self-financed program that Americans today and Americans tomorrow can benefit from, would dictate that we tailor social security benefits to revenues.

I believe in social security. I have no time to consider abolishing social security, turning it over to the private sector, making it optional, or doing any of these other things. The only option to us today is make social security work. It can be done. It is easier than you think.

It really doesn't take very much. It does require that we bite a bullet.

I have many, many objections to what the recommendation proposes. I will tick some of them off and perhaps we will talk more about them in the time to come.

First of all, controversial, about as controversial as anything here, the matter of universal coverage. Universal coverage, the Commission recommendation says, for new hires.

I do believe that Federal employees failed to understand what the Commission proposes, even if we are to mandate coverage of new hires.

I would suggest that we ought to go further because I don't believe that this country has forever a commitment to new Federal hires without any possibility of ever changing the rules.

I would suggest that at least you cover those 5 years and understand because they don't vest it until they have been 5 years there and they are not guaranteed anything until this happens.

I do agree that they should be prohibited from withdrawing, other local public employees, State employees, nonprofits; they should be prohibited upon enactment of whatever you do—and I have faith in you to do what has to be done.

Taxing, taxing those who are singles and have other income of $20,000 or $25,000 for couples, half of their social security benefits. You know as well as I know this is a major tax policy matter. This is not a social security matter. It is a major policy of some consequence and you should not consider taxing social security benefits any different than you should, for example, taxing unemployment compensation.

They are much the same, but what does it do? It provides for Treasury financing of the social security system because, even though the Treasury does collect whatever taxes are received under this taxing provision, they must transfer that income to the social security system.

This proposal establishes for the first time a means test to establish, establish an income means test allowing social security benefits without penalty which does not treat all alike if we are going to consider the matter of equity.

But, who would say that you are going to be able, if you can't prevent, how are you going to be able to prevent in the future to pressure that lower dollar number to get more income taxed?

No more than we, because I was a victim of the 1977 proposal wherein we proved that taxing would not solve the problem of social security, but look where we go to $44,000 just January next year, the pressure is going to be to drop that $20,000 or $25,000 ratio.

You are going to have, for income tax purposes, the creeping bracket or notching problem.

Consider what it does to disincentive and consider the other tools available for those who do, for reasons beyond their ability to control, have to live, by and large, on social security.

The tax is counter to the idea of prohibiting a means test, but what it really means is never, ever, are you going to be free from having your tax dollars paid into the social security trust fund. That was the ultimate hope, when you reached retirement as you would then, with an earned right program, get whatever was entitled to be your benefit, but you will never, ever, get that benefit again under those circumstances.

It suspends the COLA for 6 months. It does change the period for future calculations, but, my friends, this mistake, this COLA provision, is one of the two major problems with social security today. Of course, demographics is the other, but I can't believe, believing in equity, that the Congress can say to those who no longer work, who are retired, voluntarily or involuntarily, even though you are not in the productive sector anymore, we are going to continue annual cost-of-living increases for you. But in the instance of Federal employees, other Federal employees, for the uninformed, even though you work, even though you are employed, we are going to withhold that same cost-of-living increase for you.

The matter I find unacceptable is the increase from $20 a month to $50 a month, the disregard of social security income to qualify for SSI. That is a welfare matter. That is a welfare decision and should not be a matter for social security.

Now the taxes are increased, and I can demonstrate to you and I do have and you have my dissent in the report which is yours, and I illustrate some example how, in the short range, how in the long range, without violating those three principles I enunciated for you, which I find unacceptable, accelerating, increasing taxes, Treasury financing, or mixing unrelated taxes and Treasury financing, how these things can be done, but more than 50 percent of the revenue produced by this recommendation comes through taxes.

Worst of all, however, is that with the refundable credit you produce a disparity between the employer and the employee. I know that some would like to have this. I just don't think it will serve the best interests of a self-financed program.

The idea of getting $18 billion from the Treasury to compensate from the Treasury to the military to me seems to be just an arbitrary number that seemed to fit the magic number needed to get a certain number of dollars. The only thing I have to say to you is if those dollars are to come by transferring from the Treasury back to social security, you are going to be finding that will be slow in coming, because I am told that somewhere in the vicinity of $400 or $500 million of benefit checks are returned annually to the Treasury, and it will take a long time to provide the $18 billion which they propose with the Commission recommendation to get to the magic number of $18 billion.

I have difficulty understanding increasing the retirement bonus benefit when demographics are the problem today by increasing that percentage from 3 percent to 8 percent. There is no provision for repaying money which comes from the DI or HI trust fund. Why—and I disagree with the Commission recommendation, that if the COLA combined with the demographics constitute the major problems—why don't we get on now with doing something about the problem of the COLA rather than waiting until 1988.

But if you will read carefully the Commission recommendation, you will see that the Commission recommends that if the fund—and it never will with these recommendations; I guess I need not worry about it. But if it ever does get to 32 percent of a magic number, then we are going to go back to making our mistakes that broke the system before, and we are going to start paying people back what has been denied them with future proposals.

My friends, you have got something that is broken and it won't work. We haven't dealt with the COLA. We haven't dealt with the demographics. The age should slowly be phased up. Demographics didn't anticipate that.

And the Commission has not made a recommendation to you, the most important aspect of what has to be done with social security, and that is to provide a fail-safe device. A fail-safe device is mandatory.

Let me tell you how simple it is, and still leaves to you the option where it should be. It should be your call. But as we, you and I, attempt to stabilize social security, enact—don't stop with the Commission recommendation—enact, write into the law a fail-safe device, simply something like this.

Establish for the social security trust funds a fund ratio and express it percentage wise. Not having constant dollars, you can't express it by dollars. You have to express it with percentages. Just, for example, say no sacrosanct numbers, to illustrate what I mean. Establish a floor for those trust funds percentagewise, using Mr. Ball's figure of 20 percent. Utilize by projecting for the upcoming year, for the next year, the need to pay benefits made by law, required by law, $200 billion.

First deal with the evil of the problem. Deal with COLA's, and simply say when it comes time to pay, whatever the COLA is, whether it is based upon the CPI, whether it is based upon wages, or whichever is less, but the time comes by paying a COLA you would reduce that trust fund below that floor percentagewise of 20 percent. Don't pay that COLA. Or if you can pay part of it, pay at least that part of the COLA that you can, utilizing whatever COLA you adopt.

Second, even though, because of the nonperformance of the economy, and because of aberrations, the problem is even worse than you projected that it would be, automatically, automatically prorate that deficiency of basic benefits. It sounds real bad.

It wouldn't be that big if you did it. It probably wouldn't be more than 1, 2, or 3 percent if you prorated that deficit, but I am not saying even do that. I am just saying automatically do that, unless you, unless the Congress, increases taxes to finance that deficit.

Thank you, Mr. Chairman. Thank you for the problem. It is yours, it is no longer mine, and God bless you in your effort.

Chairman ROSTENKOWSKI. Mr. Beek.

Mr. WAGGONNER. I might say I am eligible for social security this year.

STATEMENT OF ROBERT A. BECK, CHAIRMAN OF THE BOARD, PRUDENTIAL INSURANCE COMPANY OF AMERICA, AND MEMBER OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Mr. BECK. Mr. Chairman and distinguished members of this committee: My name is Robert Beck. I am chairman and chief executive officer of the Prudential Insurance Co., and I am here as a member, of course, of the Commission. But I must also indicate that I represent the Business Roundtable, and in fact in the Business Roundtable I am chairman of its Task Force on Social Security and Pensions. I also am chairman of the American Council of Life Insurance, which has a deep interest in this matter as well, and will subsequently testify before this committee.

It has been a pleasure, a privilege and an honor to serve on this Commission. It has also been a very frustrating experience. The subject, social security, warranted the attention of these 15 members, in fact demanded it. The makeup of the Commission covered, if not all, most of the political spectrum.

The positions held by each of the members were deep and sincere, and the likelihood for agreement among the members of this Commission appeared minuscule, but the problem was and is acute.

Social security has more money going out than is coming in. The trust funds have been depleted. We had a problem crying for a solution. We have the elderly living in absolute fear that their benefits are going to be taken away, and we have the young who have absolutely no confidence at all that social security benefits will be there for them when they reach age 65.

During these Commission hearings, we heard from many who wanted to redo social security, but none on the Commission supported any of these approaches. It seemed to me, as I heard the dialog among the members of the Commission, that there was a consistency at least in these areas. Social security was too important a system, too vital to the Nation, that there were 36 million people who were receiving benefits, and that social security warranted support for not only this generation and those to come, and then we parted ways in terms of coming to conclusions about the approaches that were needed.

This is not the time for continued partisan politics. We can no longer afford the rhetoric of extremists. We have a problem which can no longer be deferred into the future. This agreement was hammered out, in my judgment, the hard way. Everyone gave up something to some degree, and perhaps that is what makes it right.

I support this agreement. It is not all that I wanted to see. I do not share Mr. Ball's confidence of big trust funds growing in the future; 1.8 percent of payroll is the minimum amount needed to meet the growing problems that will be present in social security in the future.

We have not addressed medicare, and I would agree with Mr. Greenspan that we should not have, but medicare has the potential of being a huge problem into the future, and warrants attention by the next group that has been assigned to study that.

And so I say this agreement is one that is worthy of support. Under the circumstances it is a reasonable approach. I support both the short- and long-term needs, the $168 billion, the 1.8 percent of payroll. I support the package in its entirety, and I support it line by line.

Also, like the chairman, I support the extension of the retirement age to fill the shortfall of the remaining 0.58 percent of payroll needed for the longer term. It is indisputable, people are living longer. As chairman of the Prudential Insurance Co., I was startled to see on our own numbers the very sharp improvements in longevity in the 1970's, and we expect that to continue into the 1980's and into the 1990's.

I support the recommendation that Mr. Greenspan described for extending the retirement age beyond age 65 up to age 66.

I would have preferred if there had not been an agreement to fight and struggle for age 68. I believe we need to move the normal retirement date out of the cement of age 65 and start moving it to a more realistic number. I also believe too that the demographics will demonstrate that we are going to struggle to get people in the work force in years moving around the year 2000, in order to fill our needs.

I also support the addition of a fail-safe device, a fail-safe device to be utilized if the financial economic turns in the early 1980's are unforeseen, and particularly bad. If the economy turns and we get another ratchet upward of inflation, it seems to me it will be very important to have some kind of fail-safe device, and I am willing to leave that undefined at the moment, but some fail-safe device that makes it possible for funds going out to be kept in balance with the funds coming in.

A few weeks ago I did not believe that an agreement was possible among the members of this Commission, because of where they were and what they believed. I am delighted that sufficient movement, compromise, honest soul-searching, has taken place to permit 12 members, the President, the Speaker, and the majority leader, to join together in supporting a package.

I believe it is important to note that support for this agreement requires no substantive change in the total package or line by line in order to maintain that support into the future.

Mr. Greenspan spoke about medicare and, as I indicated earlier, our projections indicate that the potentially huge deficit in medicare in the future will have to be addressed by another group. I believe then and now that this agreement was necessary for early legislation, and I urge that we separate social security from the discussions of the rest of the Federal budget, and urge you to support this agreement, and wish you the very best.

[The prepared statement follows:]

STATEMENT OF ROBERT A. BECK, MEMBER, NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Mr. Chairman and distinguished members of the Committee, I am Robert A. Beck, Chairman and Chief Executive Officer of the Prudential Insurance Company of America. While I am appearing today in my capacity as a Member of the National Commission on Social Security Reform, I am also representing the Business Roundtable as Chairman of the Roundtable's Social Security and Pension Task Force.

It has been a privilege and an honor to serve on the National Commission on Social Security Reform. Our country needs a sound, adequately financed Social Security System. Legislation must be enacted soon to restore both financial viability and public confidence in the system. The uncertainty and anxiety of those receiving benefits must be eliminated. The confidence of those paying taxes to support benefits must be restored.

The Business Roundtable strongly supports the Social Security System and recognizes its critical role in providing income security. The system has been extremely successful.

As evidence of this success, there was agreement among the experts who testified before the Commission that the aged are "as well off financially today as the non-aged." In fact, the per capita income of those over age 65 now exceeds the per capita income of the rest of the population. Social Security, in combination with other government programs and still maturing private pension programs, is largely responsible for this fact.

Social Security must be preserved for this generation as well as for future generations, and the public should rest assured that there is strong bi-partisan support for the program. This support is evidenced by the agreement reached by the Commission, representing a broad spectrum of the American public. Everyone has an important stake in assuring the continued survival of the Social Security system.

Consequently, the program is too important to be subjected to partisan politics. It is time to cease the political rhetoric and enact legislation that responsibly solves both the short and long term financing problems. The longer action is delayed, the more severe the consequences of such inaction.

Prompt enactment of the bi-partisan compromise plan agreed to by the majority of the members of the National Commission is strongly urged. While not completely consistent with the policy positions of the Business Roundtable, the Roundtable supports the plan as a responsible compromise to assure the solvency of Social Security.

The Roundtable supports the plan in its entirety including completion of the agreed upon financial goals. The plan cannot nor should not be modified in any significant manner. Roundtable support is based upon that premise.

The Commission recognized that there were no easy solutions to the financial problems we faced, and we agreed to solutions that spread the burden as broadly as possible, to achieve a fair and balanced compromise. All the members had to compromise deeply held positions to reach agreement.

I believed and continue to believe that the compromise is appropriate because it offers hope for early legislation. Now is the time to enact Social Security legislation, before such legislation becomes involved with Federal budget negotiations.

The members signing the compromise plan agreed that there were two key issues subject to debate. That is, those issues could be debated without violating the promise to support the agreed upon plan in its entirety. Those two issues are the need for a "fail-safe mechanism" and provision for the elimination of the remaining long-term deficit of .58 percent of taxable payroll.

The National Commission agreed that there was a need for a "fail-safe mechanism" to guard against unexpected adverse economic conditions developing without adequate advance notice. This mechanism is necessary in addition to the other changes recommended in the compromise plan. Even with those changes, there is no certainty that further financial problems will be avoided because of the extremely modest trust fund margins now available.

Confidence would further deteriorate if the system were faced with yet another financial crisis in a few years. A "fail-safe mechanism" would be available to avoid repeating the experience following the 1977 Amendments.

The most equitable and responsible form of such a mechanism is one that would automatically adjust cost of living adjustments if trust fund ratios were to fall below a certain level such as 12 percent of annual outlays. This would be equitable because unexpected difficulties would most likely be caused by adverse economic conditions. The working age population would normally experience a reduction in their standard of living under those conditions. A reduction in the cost of living adjustment would spread that burden among the entire population. If Congress desired, those at the lowest income levels could be protected in some manner as was done under the Commission's plan.

This proposal is responsible because it preserves the self-financing integrity of the system and avoids the use of general revenues. The use of general revenues as a "fail-safe mechanism" would only serve to weaken confidence in the system, and could ultimately lead to a needs tested program.

Again, adverse economic conditions would be the probable cause of future unexpected financial difficulties. The use of general revenues would only increase the deficits of the remainder of the Federal Government. This could have a disastrous effect on inflation and the economy at a time when we would need to encourage economic recovery.

The second issue is the resolution of the remaining long-term OASDI deficit. The long-term problems of the entire Social Security System are caused by demographics and ever-rising health care costs. They are far more serious than the short-term problems. However, there are reasonable solutions and no precipitous changes will be required if action is taken now.

The demographic problems are well-documented. The "baby boom" represents a tidal wave of future beneficiaries. Their benefits will be paid for by the relatively small "baby bust" generation. Continuing improvements in mortality compound the problems because benefits are to be paid over longer periods of time.

By the year 2000, persons aged 74 are expected to have the same life expectancy as those age 65 when that age was originally selected as the normal retirement age for Social Security.

Currently 3.2 workers support each beneficiary. Once the baby boom generation retires, "best estimate" projections currently predict there will be only 2 workers supporting each beneficiary. If those projections were modified to reflect continuation of current birth rates, as has been done by the Census Bureau, even fewer workers will be expected to support each beneficiary.

The Commission agreed that the entire long-term deficit of 1.8 percent of payroll should be eliminated. The compromise plan eliminates a large portion of that deficit, leaving the elimination of the remaining .58 percent of payroll as an issue to be resolved.

Legislation to eliminate the remaining deficit must recognize that our Commission did not specifically address Medicare. Nevertheless, the policy implications of that program must be considered for OASDI. There is a separate Advisory Council studying Medicare. The problems of that program must be faced soon.

Those problems will prove even more difficult than the problems faced by OASDI. Medicare problems are caused by the same demographic and economic conditions creating the OASDI problems. In addition, they are caused by the continuing rapid escalation of health care costs. Those costs have been rising more rapidly than either wages or prices for several decades.

The projected long-term deficit for the Hospital Insurance portion of Medicare is 5.21 percent of payroll, almost three times as large as the OASDI deficit. That deficit occurs despite massive current cost shifts which represent a hidden form of taxes. It also occurs despite overly optimistic assumptions that predict that health care costs will ultimately be controlled. Optimistic assumptions are used even though the aging of the baby boom generation will impose enormous pressures on the health care system.

Any future long-term tax increases, beyond the three already scheduled, will be required to support Medicare benefits unless one believes that severe cut-backs in Medicare are possible—I do not. Therefore, the long-term deficit for OASDI should be eliminated completely through realistic benefit promises.

I urge enactment of the retirement age proposal recommended by a bi-partisan majority of the Commission. This is a demographic solution to a demographic problem. This kind of change has been recommended by virtually all the major study groups and by experts from both parties who testified before the Commission.

The value of old age benefits increases as life expectancy increases because benefits are paid over a longer period of time. A gradual future increase in retirement ages merely offsets this continuing increase in the value of benefits.

I support the agreement in its entirety and seek no exceptions to that agreement. However, it is only fair to acknowledge that in the absence of the agreement, I would advocate a different solution to the financing problems. I believe the long-term deficit is larger than 1.8 percent of payroll. Because of this and because of the severe Medicare problems, I would recommend an earlier increase in retirement ages to 68 and a temporary modification of the growth of future benefit levels through procedures such as the bend point proposal studied by the Commission.

The bend point modification would reduce the long term deficit through a gradual reduction in benefit levels to be paid to future recipients. The public should understand that future benefit levels will grow in conjunction with economic productivity. That is, future benefits will grow in terms of purchasing power.

The bend point proposal studied by the Commission would merely reduce the level of real growth for a temporary period while helping to restore financial balance to the program. That is, benefit levels would continued to grow in terms of purchasing power but at a slower rate for a temporary period.

If enacted, this change would restore benefit levels to approximately the level which existed in 1972, before the faulty indexing procedures unintentionally increased benefit levels. This change should be viewed as the final correction of those faulty procedures.

Legislation to produce long-term financial balance should be enacted now for several reasons. First, the confidence of young workers must be restored. The best way to accomplish this is to make realistic and affordable benefit promises. Second, those who are to be affected must be given adequate advance notice for personal and financial planning; therefore, the changes should be gradual. If action is delayed, the changes may have to be precipitous. Third, the Hospital Insurance program will begin to experience large deficits by the end of the decade and these OASDI changes can help mitigate the effect of those deficits.

The Social Security program is an intergenerational transfer program. As such, we as parents have to ask the question, "At what age should we expect our children to support us and what level of income should our children transfer to us?"

If that question is answered realistically and with a sense of fairness, Social Security will continue to serve its vital role, not only for this generation but future generations as well. The recommendations of the National Commission should be enacted as soon as possible. Decisive and intelligent action is needed now.

Chairman ROSTENKOWSKI. Thank you, Mr. Beck.
Ms. Fuller.

STATEMENT OF MARY FALVEY FULLER, MEMBER OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Ms. FULLER. Good morning, Mr. Chairman and other members of the committee. I am very appreciative of the opportunity that we have to build on the report with some oral comments. You have all heard how difficult it was for us to come to an agreement. That is certainly true, and I think each of us individually who supported the package supported it in view of the fact that there were individual items that we feel very strongly about, that we nonetheless went along with in the interests of compromise.

I would like to organize my remarks in three sections. I think, most importantly, I would like to make some comments about the long range, and the recommended solutions to that. I would also like to make some comments about balance of burden, if you will, between the taxpayers and the beneficiaries, and then finally I would like to cover some issues that are referred to as women's issues, although I don't think they are confined in their effects to women.

First, in terms of the long-range problem, I agree with the comments that have been made that the long-range projected deficit of 1.8 percent of payroll is conservative. We have always found, at least in the last several years, that economic performance consistently comes in worse than the pessimistic assumptions in the trustee's report.

We agreed, in the Commission, to use the intermediate assumptions when we projected out 75 years. It is hard to come up with one set of projections that is any better than any other, without going for the middle ground when you are going that far out into the future, but I do think that we should bear in mind that 1.8 percent is conservative. I don't think we can afford to let that gap go unclosed in your deliberations. I think that to close it completely is required, because chances are we are going to need at least that much if not more.

I also support the proposal in the package that calls for a gradual increase in the retirement age. I won't elaborate on the increases in longevity. You all know that. There have been many studies that support that. In fact, if you were to calculate in the year 2015—and everybody seems to gravitate to the year 2015 as the year to have a change to be fully effective, because you can start phasing in either in the year 2000 or the year 1990 and give everybody notice and adequate time to plan.

If you take that year, and you ask what the retirement age would be in the year 2015, such that the original age of 65, when it represented a certain proportion of a worker's life spent working and a certain proportion in retirement, if you take that proportion and extend it out to the year 2015, when would people be retiring? The answer is 71. That is 6 years later than the current age of 65.

Now, I think that as standards of living grow, and one can debate whether it is appropriate to alter that balance and share this increased longevity between the beneficiary and the worker, one could say, well, in the interests of equity, if you split the difference, take that 6 years, divide it in half, you would end up with a retirement age of 68.

This also is consistent with studies that have been more analytically based—for example, based on ability to work and at what point people's physical ability to work starts to decline. Many studies from different points of view have come up with the age 68.

Had we not reached agreement, I, too, like Mr. Beck, would have supported moving gradually to age 68. Like Mr. Beck, I support the package in its entirety, and I support the proposal to go to age 66, but I also think as a matter of perspective, when you think about the age 66, you should think about it in terms of a longevity that would have gone to an age 71, if you were to retain the same proportion of a person's life in retirement, so to go 1 year to age 66 does not seem to be an unreasonable change to make, given the increased longevity that we all know about.

I also think the indexation is important, because the demographic changes have continued. I think that it is very difficult to negotiate retirement age. People always seem to feel that there is something taken away when you change something from what they had before.

I think it is much more objective and therefore much easier to deal with politically if you can take a point in time and use some kind of an indexing that is more automatic, that is more based on reality and on objective information, so I would urge both age 66 as the least we can do and as something that is necessary to close what I believe will be a real long-term financing gap, and I support the indexing part of it as well.

Now to the second part of my comments, the balance between increases in taxation and restraint in growth of benefits. I support this package even though it derives well more than half of the $168 billion short-term gap from additional sources of revenues and from tax increases. I do want to make a couple of comments, though, which may be useful, as I know the debate will continue in these deliberations.

In 1977 when the short-term financing gap was identified, the answer then was taxes. We are dealing now with the time period for analytical purposes and for real purposes from 1983 to 1989. If you take the effects of the 1977 amendments, those tax increases, and calculate how much of those tax increases apply over that 1983 to 1989 period, the answer is about $300 billion, so the tax increases and additional sources of revenues that are part of our package come on top of $300 billion already enacted in 1977.

Again, I support the package. I think compromise is vital, but I think that this compromise should be taken in perspective, and in the context of keeping some kind of balance between the burden, the increased burden that is asked of the workers, both in this generation and the next generation, and the burden that is borne by the beneficiaries, I think that we are asking the workers to pay about as much as it is realistic and fair to ask them to pay, and I think that should be borne in mind.

On the question of the refundable tax credit, this was part of the package that I had the most difficulty in signing on for, and the reason is that this is without doubt the infusion, although on a temporary basis, of general revenues into the social security system.

The system has been built on the concept that it is self-financing, that it is an earned right, that it is financed by the contributions in the aggregate of the workers in the aggregate. I feel this is a fundamental principle.

I can understand why those who felt it necessary to put this refundable tax credit into the package did so. The rationale here was that when you are increasing taxes at a time when the recovery is just beginning to start, at a time when unemployment is high, you certainly don't want to put pressure on employers to such an extent that there would be any chance of further increasing unemployment. This was the rationale that was given for putting in this refundable tax credit for the year 1984.

I would urge extreme discipline in dealing with this tax credit. If we need it for 1984, so be it. However, I think it is very important that we not repeat such an action, that we make sure, in whatever package that we end up with—and I do hope it is this package—that we do close the gap so that we aren't faced with the need to do something like this again, because I think this can erode, over time, the confidence in the system as an earned right system, and therefore its freedom from being classified as another welfare program. I think that is very important.

Now, finally, the issues relating to women. I think the issues relating to women are referred to in that light because they relate to the changed roles of women in the work force, and consequently to some inequities that now exist in social security that were never intended to discriminate against women or anybody else, but that now exist because the nature of the work force, according to its sex makeup, is different.

When social security was enacted in 1939, you had primarily one-wage earner couples. People married young. They stayed married to the same person for most of their lives, and you had intact one-wage earner families. The dependents benefit was a natural outgrowth of that family construct.

In fact, what we have now is a change in the family construct. Most families have two wage earners, and most marriages, unfortunately, are not lifelong, so you have more and more spouses, both sexes, that are part of two-wage earner families, and you have more and more women who are divorced and heads of households.

Because the program continues to be based on the concept of dependents benefits, there are at least four unintended inequities that now affect a very large number of people, men and women. One of them is that the secondary earner—defined as the earner, who earns less, and in most cases happens to be a woman—unless she earns more than one-third of the total family income, she gets no more in benefits from having paid into social security all her working life than she would if she had never worked at all.

Now the secondary spouse does get disability coverage, which would not exist without working, but this is a small benefit relative to years and years of social security taxes, so this is an inequity. There are many, many people working in the work force as secondary earners and as part of a two-earner couple who get nothing more from their taxes than they would if they didn't work at all.

Second, when a couple retires, if it has two workers in it there are less benefits in total than if there were one worker with the same earnings, and that is a question of equity. The same amount of money is going into the social security system and not the same is coming out.

Third, a single person retiring with a given amount of earnings gets less than a married person retiring with the same earnings.

Finally, if a person is divorced, and the marriage has not lasted an arbitrary number of years—right now the number is 10, it has to last 10 years; it used to be 15—there are no benefits accruing to that person in his or her own right, and there are lots of people—two thirds of divorces occur after less than 10 years of marriage—so these are, to my mind, the major inequities, never intended as inequities, but inequities that now exist because of the changing participation of women in the work force and the fact that we do not have as our model the one-earner, lifelong married couple.

Now the proposal that I support, and which has, I think, received growing support from people of all political persuasions, is the concept of earnings sharing. Under this concept you take the total earnings of a couple during the life of a marriage, you add them up, divide by two, and credit each spouse with that amount of earnings. It is based on the premise of community property which has been applied in several of our States in marriage situations. It recognizes that the marriage is an economic partnership.

The decision of who stays at home and works in the home and who works in the paid labor force is the decision made by the family, and it should be funded by the family. It is a free country, and this kind of an approach divides the family income within the family unit, which is the way those decisions are made, and the way that income is managed.

Now I believe that this can be implemented. People talk about how complicated it is. Certainly like any other change in social security, it has to be implemented with some advance notice, so that all people affected by it can plan ahead for it. It does not have to result ultimately in any increased cost to the social security system.

Now people say earnings sharing is very expensive. Partly it is because they add other benefits. They say if you go to earnings sharings you should provide disability to the homemakers. Since that is not provided for now, you need money to pay for it. Earnings sharing is not required to do that. As a separate subject, that can be debated on its own merits but it is not part of earnings sharings, to my mind.

I have talked to people, Democrats, Republican women, men, people who work in the home, people who work in the paid labor force. There is a certain ring to this concept that it is fair, that it gives people earnings credits in their own right. It recognizes contributions to the marriage. It does not transfer women from being dependent on men to being dependent on taxpayers or society or the Government.

I think that it is something that you should consider. It is clearly not a short-term solution to any financing problems. I certainly don't recommend implementing anything in the short term that is going to cause increased costs, even if it is for the transition. I think it should be planned to be implemented in a way that integrates into preserving the financial health of the system, but I think that a change of this magnitude needs to be planned well in advance.

It needs to be debated. It needs to be understood, and it needs to be supported, because only then will we be able to move from here to there in some kind of orderly way.

Thank you very much.

[Subsequently, Ms. Fuller requested that her supplementary statements in the Commission's report be included in the record:]

SUPPLEMENTARY STATEMENT BY MARY FALVEY FULLER

WORKING TOWARD MEANINGFUL SOCIAL SECURITY REFORM

After a year's work, the National Commission on Social Security Reform, together with the White House and the Speaker, have produced a package with the potential to be passed into law within the next few months. The overriding objective of our recent negotiations was to produce a package that would generate enough support to be enacted by the Congress in time to prevent either delay of benefit checks in July of this year or an emergency infusion of general revenues. As a result, the compromise includes elements that are distasteful to many Commissioners for different reasons.

In my view, the package contains two major provisions that are commendable:

1. *Extension of coverage to new Federal employees and all employees of nonprofit organizations,* so that Social Security becomes closer to a universal-coverage system.
2. *Shift in the COLA to wages or prices or lesser after 1988* if the trust fund ratio falls below 20 percent. Although this stabilizer of outgo relative to income is effective only in times of real wage loss, it is a step in regulating the COLA to reflect economic conditions.

However, there are a number of additional provisions that I believe are necessary for meaningful reform that we should work for vigorously in the months and years ahead, specifically:

1. *A clear commitment to increase the retirement age* to reflect the increased longevity of the American population. The increased life expectancy of beneficiaries, coupled with the declining birthrate, means that we will have only two workers supporting each beneficiary in 2025 and after, in contrast to the 16 we had in 1950.
2. *A combination of COLA stabilizer and fail-safe mechanism* to guarantee that crises like the one we face now, and the one we had in 1977, will not recur before the end of the decade and in the future.
3. *A balance between tax increases and benefit restraints* that is realistic and fair over the long term. This package relies on new sources of revenue and tax increases for about $100 billion of the gap of $168 billion, and the tax increases come on top of $300 billion enacted in 1977 that apply to the 1983-89 period. Relatively little has been accomplished to date in restraining the growth of benefits over the long term.
4. *Reliance on the payroll tax as the sole source of financing.* This is essential to preserve the discipline in managing the growth of benefits relative to taxes, the parity between the employer and employee contributions, and the earned-right character of the program.

The remainder of this statement discusses each of these areas.

Clear commitment to increase the retirement age

The bi-partisan package leaves open a gap of .59 percent of payroll as part of the total long-term gap of 1.80 percent. The package stipulates that the gap would be filled by either a gradual increase in the normal retirement age or a combination of other measures. I support the proposal to fill the entire gap through a gradual increase in the normal retirement age. In fact, I believe that this measure, while adequate based on the economic projections used in costing out the package, may fall short of what will actually be needed. Furthermore, the age of 66 in 2015 is about 5 years below the age at which a person would work the same portion of his/her life as that determined by using age 65 when it was enacted in 1935. Consequently, I believe that the increase in the normal retirement age should be adjusted at some later time so as to reach age 68 by 2015. This would produce long-range savings of 1.3 percent of payroll. There is a growing belief that this will be needed to fill a long-term gap of 2.4 percent of payroll, which results from the latest projections of fertility rates by the Bureau of Census.

The Congress and the public may not be aware that actual economic performance has, in recent years, consistently fallen short of the most pessimistic economic projections made in the annual reports of the Board of Trustees. It would be responsible, forward-thinking policy to provide for this gap soon—especially since a retirement age of 68 is what the many research studies have shown to be appropriate by the year 2015 to reflect longevity at that time—even allowing for some growth in the proportion of life spent in retirement. One could then delay the indexing schedule to begin after 2020 if the trust funds show a substantial surplus. This would be fairer to the working population than allowing another crisis to loom before taking needed action.

Combination of COLA stabilizer and fail-safe mechanism

The bi-partisan package includes a provision that would substitute the lesser of the percentage wage increase or the percentage price increase, beginning with 1988 if the combined OASDI trust fund ratio falls below 20 percent. While this is a positive step, it is possible that action will be needed before 1988 to avoid another funding crisis. Several Commissioners had proposed putting a cap on the COLA between 1984 and 1988 or basing the COLA on wage increases minus 1½ percentage points. The latter method would make the adjustment independent of the CPI and yet produce exactly the same benefit increases over the long-term, (after the 1980s) as under present law, if economic conditions are the same as those assumed under the intermediate assumptions of the 1982 Trustees Report. On the other hand, if economic conditions are unfavorable, and wages do not exceed prices by as much as is projected, the financial solvency of the program would be protected, because benefit increases would be smaller than under present law. Conversely, if economic conditions are more favorable than assumed, benefit increases would be larger than under present law, and the financial condition of the system would still be strong.

If another funding crisis develops before 1988, we will be faced with further tax increases—on top of those enacted in 1977 and those that are proposed in the "consensus" package--or another COLA delay. I hope that this does not occur, because our credibility in controlling the financial condition of the Social Security program would be damaged in the eyes of the American people. However, based on recent experience with actual economic conditions versus projections, we cannot rule this out.

Several of us also recommended a fail-safe mechanism to ensure that benefits would continue to be paid on time despite unexpectedly adverse conditions, which can occur with little advance notice. One mechanism would be to reduce, temporarily, benefits payable. Alternatively the same result could be accomplished indirectly by reducing the next benefit increase that would occur as a result of the COLA. Another mechanism could be to increase, temporarily, the OASDI tax rates. Because of the already large tax burden on today's workers, I would favor the first or second alternative. I recognize that Congress is more likely to respond to actual, rather than potential crisis, but I am concerned about further damaging public confidence in the Social Security program by frequent short-term threats.

Balance between tax increases and benefit restraints

The current estimated short-term gap of $150 to $200 billion for 1983-89 comes on top of a tax increase in 1977 that amounts to about $300 billion during this period. The bi-partisan package contains new sources of revenue and tax increases of about $100 to $130 billion depending on whether the taxing of benefits is classified as a tax increase or a benefit reduction. In any case, this means that at least $400 billion in new revenues and tax increases will have been enacted in 1977 and after to close a gap of $500 billion. This is, in my view, an unbalanced reliance on taxes, which places an excessive burden on today's working population, while holding retirees relatively harmless. There is a limit to the psychological as well as financial capacity of the working population to absorb continued tax increases. This is especially true during times when they are asked to accept wage increases that do not keep up with inflation.

The clear preference for tax increases rather than benefit restraints has been shown by the actions taken over the last decade. This is one of the major reasons that young people are afraid that the Social Security program will not be around to support them when they retire. The public may be beginning to realize that our overall budget deficit of about $200 billion is, essentially, a commitment on the part of the next generation to pay increased income taxes. The combined effects of increases in Social Security taxes, income taxes and, inevitably, Hospital Insurance taxes appears formidable, to say the least, and unfair when certain groups of people are partially exempt.

Reliance on payroll tax to finance social security program

The Social Security system has been based on the philosophy that benefits are financed by payroll taxes, paid equally by employers and employees. The bipartisan package contains a refundable income tax credit for 1984 that would offset the payroll-tax increase. This is a direct violation of this fundamental principle; it upsets the parity between employer and employee contributions and infuses general revenues into the Social Security program. It should not be repeated under any circumstances. In my view, it is essential to maintain the self-financed character of the Social Security program—both to maintain discipline in managing the system and to protect its status as an earned-right, rather than a welfare program. The self-financed character of the system is essential to prevent moving to a system that condititons benefits based on financial need. Furthermore, to inject general revenues at a time when we have the highest budget deficits in American history, it is very unfortunate and should not be repeated in any form. Americans value the Social Security system as a contributory program, and this is essential to the long-term health of the system.

It has been a privilege to serve on this Commission and, though many of us have had to swallow hard, some constructive steps have been taken. I am hopeful that some meaningful reforms will emerge from the up-coming deliberations in the Congress.

SUPPLEMENTARY STATEMENT BY MARY FALVEY FULLER

ADDRESSING THE CHANGING ROLE OF WOMEN

The effect on women of the Social Security program is a subject of major importance, and much analytical work has been done to identify and evaluate alternative approaches to correct the unintended inequities. In fact, the 1979 Advisory Council on Social Security spent more time on this issue than on any other single issue. Unfortunately, our commission could not address this issue due to the urgent priority of restoring the solvency of the system. But we do not intend this choice to detract from the importance of restoring the equitable treatment of women in today's world. The provisions of the bi-partisan package, while advantageous to certain groups of women, do not begin to address the fundamental, though unintended, inequities, that act to the disadvantage of all people except members of intact one-earner couples.

The Social Security system was designed at a time when most families each had one wage earner with a dependent spouse, and marriages were, for the most part, lifelong. As a result, the benefits of the dependent spouse are determined as a function of the earnings of the worker, and divorced spouses do not receive any benefits unless the marriage has lasted for more than arbitrary number of years (which is now 10). Today, the times are different; a substantial majority of women spend most of their lives in the paid workforce, and there is one divorce for every two marriages, with two-thirds of divorces occurring after less than 10 years. The Social Security program, therefore, has some unintended inequities that need to be corrected:

1. The secondary earner, in most cases the woman, gets little, if any, return on her Social Security taxes. Only if she earns more than one-third of the combined couple's income do her benefits as a worker exceed those she would receive as a dependent spouse.
2. Two-earner couples receive less in benefits than one-earner couples with the same earnings. Survivors of two-earner couples are, correspondingly, penalized.
3. Single retirees receive lower benefits relative to their tax contributions than married couples.
4. The spouse receives no benefits on divorce unless the marriage lasted 10 years or more.

These inequities result from the continued use of the concept of a dependent spouse which is, in today's world, an anachronism. Marriage today is an economic partnership, and each partner contributes to the well-being of the family. The most direct method of restoring the proper treatment of both spouses is through a program of earnings sharing, where each spouse receives credit for one-half of the combined earnings of the couple during the life of the marriage. In this way, each spouse receives credit for her/his contribution to the marriage year-by-year with no requirement based on duration of the marriage. The conceptual precedent is community property, which prevails in several states.

Such a program would need to be tailored to special circumstances, such as protecting the family in the event of loss of the primary earner's income through disability. Moreover, the transition would need to be orderly and fair, which is not to say, protracted and expensive. However, there is in my view, no need to hold harmless groups (like divorced men) whose total benefits may have been high relative to their contributions. There is also no need for increased costs except for the transition. The earnings-sharing program developed for evaluation by the 1979 Advisory Council had an increased cost of .09 percent of payroll—excluding the cost of adding disability protection for certain groups, primarily homemakers. I do not believe that the evaluation of earnings sharing should be complicated by adding benefits that do not exist today. Responsibility for supporting homemakers during retirement and disability is a separate subject with different arguments, which are based on different issues.

The fact that transition to such a program will be complex to design and implement should not prevent this much-needed change. Work on the program should begin now so that the details can be worked out and communicated well in advance. Implementation should begin as soon as the system is in a position to support the cost of transition—hopefully by 1990. Change is natural in a healthy society, and effort is better spent implementing orderly change than trying to force-fit elements of the status quo that have outlived their relevance.

Chairman ROSTENKOWSKI. Thank you.

Mr. Trowbridge.

STATEMENT OF ALEXANDER B. TROWBRIDGE, PRESIDENT, NATIONAL ASSOCIATION OF MANUFACTURERS, AND MEMBER OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Mr. TROWBRIDGE. Thank you, Mr. Chairman. Like my colleagues, I appreciate the chance to add some comments on our Commission's activities, and I will keep them brief. I am Alexander Trowbridge. I am president of the National Association of Manufacturers. I served on the Commission as a Democrat appointed by the President. I am appearing here in support of the Commission's recommendations as an individual, as a member of the Commission, and I hope by the end of this week to be able to say so on behalf of my organization as well.

We, Joe Waggonner and I, shared the honor of being appointed as Democrats by the President, but we did not come out with the same conclusion at the end of the year's activities. I do support the package. I too went back and looked at our charter given to us by the Speaker, the President, and the Majority Leader. At the beginning of last year we were asked to really do four things: to review and define the problem, to analyze the causes and all aspects of that problem, to define options for its solution, and then to recommend the best course of action that we could determine to solve the problem.

I think it was obvious from the beginning that it was impossible to hope for a unanimous vote. The fact that 12-to-3 consensus vote came forward was somewhat of a surprise, and it really fell into place in the last 24 to 48 hours of the Commission's existence.

I would like to comment on two parts of the Commission's recommendations, and at the same time ally myself with many of the comments made on other parts by our previous speakers. Going back to the meeting we held in Alexandria in November 1982, after the congressional elections were completed, during that 3-day meeting we really established the first parameter of our work. This was the important definition of the problem as being a roughly $150 to $200 billion OASDI fund shortfall between 1983 and 1990, and 1.82 percent of payroll over the long term of 75 years. The fact that we agreed on that definition was essential to the further progress of the Commission.

We also agreed at that meeting that we, with the one stated exception of Mr. Kirkland, would favor extension of coverage to the Federal civil service, and to nonprofit organization employees. At that point we were talking in terms of Federal civil service employees with 5 or less years of service and who therefore had not been vested. We really had about a 14 to 1—even though we didn't count votes—but we had about a 14-to-1 consensus that that recommendation should be part of our report. It subsequently remained in the report, but it did not cover Federal employees beyond new hires, as you are aware.

Since the report has come out, those of us who live in Washington, and I am sure elsewhere, have heard a number of radio broadcasts and public statements very critical of the idea of including Federal civil service employees in social security, and making a large number of what I consider to be ill-supported charges in argument against the recommendation.

Mr. Chairman, with your permission, I would like to submit for the record of the committee a memorandum which we have received dated January 31 from Mr. Robert J. Myers, who has been absolutely outstanding as Executive Director of the Social Security Reform Commmission for the past year. It deals with the subject "Controversy Over Our Recommendation To Cover New Federal Hires." I won't go into the full details of that memorandum.

It is a very comprehensive discussion of the nature of the criticisms, and given answers that are appropriate to those criticisms, and which serve to defend the Commission's recommendations for extension of coverage. I believe it is a valuable document that the committee would find useful.

Chairman ROSTENKOWSKI. Without objection, it will be received. It will be made part of the record.

[The memorandum from Mr. Myers follows:]

NATIONAL COMMISSION ON SOCIAL SECURITY REFORM,
Washington, D.C., January 31, 1983.

MEMORANDUM

To: Members of the National Commission on Social Security Reform.
From: Robert J. Myers, Executive Director.
Subject: Controversy Over Our Recommendation to Cover New Federal Hires.

As you well know, several groups of Federal employees have mounted a strong campaign against our recommendation to cover new Federal hires under Social Security.

This campaign is based on several significant factual inaccuracies—such as that it will bankrupt the present Civil Service Retirement System within a few years, that it will cost the Federal Government vast sums of money, and that it will cost the Social Security program more money over the long run, despite short-term cash-flow gains. None of these assertions are true. The attached memorandum analyzes the situation in detail.

ROBERT J. MYERS.

Attachment.

NATIONAL COMMISSION ON SOCIAL SECURITY REFORM,
Washington, D.C., January 31, 1983.

GENERAL MEMORANDUM

From: Robert J. Myers, Executive Director.
Subject: How Would the Financing of the Civil Service Retirement System be Affected by the National Commission Proposal?

The National Commission has recommended that all Federal employees hired after 1983 should be covered under the Social Security program and that an independent, supplementary Civil Service Retirement (CSR) plan should be developed for these individuals. This would be exactly the same general procedure that is followed in the private sector and in much of the state-and-local-government sector.

CRITICISMS OF PROPOSAL OF NATIONAL COMMISSION

A number of Federal-employee organizations have criticized this proposal, on several grounds. I do not believe that their criticisms are valid, however. I will consider each of the recently-heard arguments against this proposal and either point out the flaws or show that the recommended procedure is consistent with generally accepted pension-funding principles, particularly those that have been used over the years in analyzing and valuing the CSR system.[1]

The principles of such criticisms are as follows:

(1) It has been claimed that covering all new hires under Social Security will bankrupt the Civil Service Retirement System, because there will be a decreasing group of active workers on whose salaries contributions will be paid by them and by the Government.

(2) It has been asserted that the Social Security System will have only short-term cash-flow gains, and the additional benefit liabilities created will put it in a worse position in the long run.

(3) Some allege that new hires will be worse off, because they will have only Social Security benefits.

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[1] Any views expressed in this memorandum are those of the author, and not necessarily those of the National Commission. However, any factual statements are completely objective and completely accurate.

(4) Some claim that the Government—and thus the general taxpayers—will have higher costs, because they will be required, more or less immediately, to "pay off" the unfunded accrued liability of CSR (at least about $200 billion, but as much as $500 billion under some funding bases). Also, the Government will have reduced income-tax receipts, because a larger proportion of CSR pensions is taxable than for Social Security benefits.

Before reputing these criticisms, I will first give a general description of the CSR plan, especially as to its financing basis and principles.

GENERAL DESCRIPTION OF CSR SYSTEM, ESPECIALLY ITS FINANCIAL BASIS

First, and most importantly, it should be recognized that the CSR Fund is not one single retirement plan. It is a little-known fact that it is composed of a considerable number of plans. For example, it includes a plan for Members of Congress, another plan for congressional employees, another plan for air controllers, another plan for general employees, etc. It also includes a number of "closed" plans, for which there are no current active contributors—only pensioners. Examples of such "closed" plans are the three separate plans which were prevalent in the mid-1930s, when one applied to persons in generally hazardous work (with a retirement age of 62), another applied to postal employees and blue-collar workers (with a retirement age of 65), and the third applied to general employees (with a retirement age of 70). For all three plans, the benefits formula—which still applies to pensioners therefrom who are now on the rolls—is far different from the one applicable to current contributors.

The financing for the CSR Fund is determined on a single aggregate basis for all of the plans considered as a whole including the "closed" plans. Thus, the establishment of a new plan for new hires only within the CSR Fund would not diminish at all the payroll base for purposes of contributions by the Government.

Considering only present general employees, their contribution rate is 7 percent, their employing agency pays another 7 percent, and—although it is not always recognized or known—the General Fund of the Treasury pays, on the average, over the long run—an additional amount approximately equal to 26 percent of payroll. It is sometimes erroneously stated that this latter amount of 26 percent is entirely due to the fact that the Government did not make proper (or any) contributions in past years. This is now the case; only a small part of the 26 percent arises from such insufficient payments. For further details and explanation of this matter, see the attached paper, "How Much Has the Federal Government Contributed to the Civil Service Retirement System?"

This relatively high cost of CSR, amounting in the aggregate to about 40 percent of payroll is the result of several factors—(1) the very low retirement ages provided (for general employees, age 55 with 30 years of service; age 60 with 20 years of service; or age 62 with 5 years of service); (2) the relatively high pension rates for long-service employees; and (3) the full indexing of benefits to the CPI.

The basic actuarial-funding basis of CSR, as it will be done in the future, is that the accumulated unfunded liability will never be liquidated. Rather, interest on it will be paid every year into perpetuity (as it has been in the past). This will provide adequate financing at all times, and it is a quite appropriate procedure for a Federal government plan. Such interest will quite be expressed as a percentage of payroll of the total then-active workforce, even though many of them—eventually, all of them—will not have had anything to do with the creation of the unfunded liability itself!

As to the matter of whether CSR is soundly and adequately financed—which I believe is the case—this could properly be said to be the case for the long-range future, because the present law provides that the General Fund of the Treasury will pay the balance of the cost over what is met by the 7 percent employee contributions and the 7 percent agency contributions! Of course, the Social Security program would also be soundly and adequately financed under the recommendations of the National Commission on Social Security Reform.

ANSWERS TO CRITICISM OF PROPOSAL OF NATIONAL COMMISSION

(1) *CSR will be bankrupted because it will have no new entrants.* The proposal would not place CSR in jeopardy within a few years because "income would stop flowing into the fund", as some assert. The proposal would not substitute Social Security for CSR, nor would the system be "merged", but rather a supplemental CSR program would be developed, just as has been done so successfully in private industry. This supplemental system would be part of the CSR Fund, which now contains several retirement systems. It is quite likely that, under the total retirement system

for new hires, the total contribution rate for employees and for the employing agencies would remain the same as it is present employees—namely, now 7 percent, plus the Hospital Insurance contribution rate and that the excess of the 7 percent rate over the OASDI rates would go into the CSR Fund. In addition, the approximately 26 percent of payroll which now, on the average over the long run, goes into the CSR Fund from the General Fund of the Treasury (or a slightly different determined rate) as an aggregate residual payment to meet the cost of all of the various retirement plans contained in the CSR Fund would continue. Accordingly, no part of, and no separate plan in, the CSR Fund would be endangered.

(2) *Social Security will gain only over the short run, but will lose over the long run, due to the additional benefit liabilities created.* It is often stated that "Within the last three years SSA has testified before Congress that while coverage of federal employees would help the short-range financing problem, it would only add to the problem in the long-range." I am constrained to say that Deputy Commissioner Robert P. Bynum in testifying to this effect in 1979 before a congressional committee was completely wrong, and he was told so by the actuaries of the Social Security Administration and did not choose, either then or later, to correct his statement.

Social Security coverage of Federal employees would give sizable cash-flow income to the Social Security program in the short range. Over the long run, such action would be favorable to its financing—not unfavorable. A significant long-range savings to the Social Security program is estimated to result—about .3 percent of taxable payroll, on the average, over the 75-year valuation period, according to the estimates of the SSA actuaries. Moreover, despite what leaders of some Federal-employee organizations say, the SSA actuaries have always estimated that there would be a significant long-range savings to the Social Security system if coverage were extended to Federal employees (whether to only new ones or whether to present ones as well).

(3) *New hires will have only Social Security benefits, and these are not nearly as good as CSR ones.* No responsible group has ever proposed that CSR would be completely eliminated, and only Social Security benefits be available. Rather, an independent, supplementary CSR plan would be developed—just as is done in the private sector. Many employees would be better off under such a basis, particularly short-service workers (who now have little or no current disability and survivor protection under CSR, and may continue to be in a disadvantageous position for some years after they leave Federal service and enter the private employment sector).

(4) *Taxpayers will have higher costs under the proposal.* This is not necessarily the case, depending upon the nature of the independent, supplementary plan. Certainly, it is not the case for the reason sometimes given that the unfunded liability would have to be paid off at once. I have demonstrated the fallacy of this criticism and approach in the last paragraph of the previous section.

The criticism that the general taxpayer will suffer because income-tax receipts with respect to the pensions of the "new hires" arising from both the new independent, supplemental plan and Social Security combined will be less than if the total pension were from CSR alone is quite true. However, this is a classic example of "walking on both sides of the street". Federal employees have—quite rightfully—been arguing for years that their pension income is unfairly taxed as compared with the (current) tax-free Social Security benefits (although, in reality about 80 percent of CSR retirees aged 62 or over are also eligible for at least some tax-free Social Security benefits, based on "outside" employment!). In all logic, that portion of CSR benefits which is equivalent to Social Security benefits, less any actual Social Security benefits received, should be as tax-free as Social Security benefits. Now, some Federal-employee groups are using this inequitable, disadvantageous treatment as though they are being "patriotic" by being mistreated and want to continue to be so treated!

In summary, it really all boils down to the simple fact that, if the Government requires private employers to have Social Security for their employees instead of only a private pension plan (but with such plan being possible, and desirable), then why should it be different for its own employees? This is especially so for employees of the Social Security Administration. It is (or should be) extremely difficult, if not impossible for an SSA employee to explain to the public what a great program Social Security is and be able then to give an adequate answer to the question, "Well, if Social Security is so great, why aren't you in it?"

ROBERT J. MYERS.

Attachment.

HOW MUCH HAS THE FEDERAL GOVERNMENT CONTRIBUTED TO THE CIVIL SERVICE RETIREMENT SYSTEM?

(By Robert J. Myers) [1]

Frequently, one hears that the relatively high cost of the Civil Service Retirement system to the General Fund of the Treasury is due to the fact that, for many years, the General Fund did not contribute its appropriate share. This article will consider this matter in some detail—and especially the allegation that, for many years, the Federal Government did not make any contributions at all to the CSR system.

In fiscal year 1981, the government contribution was $18.2 billion, or about 4½ times the employee contributions of $4.0 billion. It is likely that this ratio—or possibly even one as high as 5 to 1—will occur in future years.

The accompanying table compares the employee contributions with the government contributions to the CSR system for selected fiscal-year periods in the past, going back to when the program first began operations. In the first 8 years, the government did not contribute at all, despite the fact that from the standpoint of sound financing, government contributions should have been made then. However, the total amount of employee contributions then was only $143 million. Thus, if the government had put up an equal amount (or even somewhat more), with accumulated interest over the somewhat more than 50 years, this would not have increased the existing fund balance by more than about $1 billion, or only 1 percent relatively.

From 1929 through 1969, the government contributions were slightly less than the employee contributions—by about 10 percent in the aggregate. Once again, from the standpoint of sound financing, the government contributions should have been larger, but even so, the current fund balance would not have been much higher. In the past 12 years, the picture has changed greatly. The government contributions have been about 3 times as large as the employee contributions—and, as noted previously, by as much as 4½ times in the last year.

In summary, then, it is true that the Federal Government did not contribute adequately to the CSR system in the first five decades of its operation, but that, recently, quite adequate contributions are being made. If more adequate contributions had been made in the early decades of operation, there would be higher interest income currently, but this would not greatly reduce the cost to the Federal Government, either currently or over the long run.

The average cost of the CSR program over the long-run future is currently estimated to be approximately 40 percent of payroll. After considering the employee contribution rate of 7 percent, this leaves a remaining cost to the Federal Government of about 33 percent of payroll (of which 7 percent comes directly from the employing agencies through their appropriations, with the remaining 26 percent coming indirectly from the General Fund of the Treasury). The Board of Actuaries of the CSR system estimates that the normal cost of the program is about 14 percent of payroll, using static economic assumptions (i.e., assuming—quite unrealistically, in this real world—that general wage and price levels do not increase in the future). On the basis of this figure, some people mistakenly believe that, because the employees contribute 7 percent, the cost to the Federal Government would really be only the remaining 7 percent if it had contributed properly in the past. This argument is fallacious for several reasons.

First, the normal cost applies only to new entrants. The relatively high cost for persons who came into the system initially at older ages with creditable past service is an appropriate part of the cost of the program and is not explained away by saying that past government contributions were not made.

Second, the interest rate used by the Board of Actuaries in computing the normal cost under the static assumptions is unrealistically high at 5 percent. Such a real rate of return is most unlikely to be achieved under conditions of no price inflation. Instead, a rate of 1 percent to 2 percent should be used under these circumstances, and this would produce a normal cost of about 30–37 percent of payroll.

In fact, the Office of Personnel Management, using the actuarial model developed by the Board of Actuaries, but with a 1 percent real interest rate, has estimated the normal cost to be 36.7 percent of payroll (in a report submitted in accordance with P.L. 95–595). Such a figure plus an addition to allow for merely paying interest on the unfunded accrued liability (which would be held constant in relation to payroll)—both that which should have been funded by adequate government contributions in the past and that which would have existed nonetheless—would show that the government cost for the CST system is really at least 4 times the employee contribution rate of 7 percent.

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[1] Chief Actuary, Social Security Administration, 1947–70; Deputy Commissioner of Social Security, 1981–82; Executive Director, National Commission on Social Security Reform, 1982–83.

EMPLOYEE AND GOVERNMENT CONTRIBUTIONS TO CIVIL SERVICE RETIREMENT FUND

[Dollar amounts in millions]

	Employee contributions	Government contributions	Ratio of Government to employee contributions (percent)
Fiscal year period:			
1921–28	143		
1929–45	1,321	1,137	86
1946–60	6,934	5,113	74
1961–69	9,799	10,197	104
1970–81	33,616	100,315	298
1921–81	51,812	116,764	225

Mr. Pickle. Could I ask if that document is available now?

Mr. Trowbridge. I have a copy, Mr. Pickle, and I am sure that other copies can be made quickly.

The other portion of the comments that I would like to add deals also with the question on which the Commission took a divided position; the question of long-term reforms which would meet in some predictable and comprehensive way the needs of the system over the 75-year period that we were examining. You are aware that the majority of the Commission members favored a change in the retirement age, a minimal change as described in the report of only 1 year, from 65 to 66. I believe that there is the possibility of extended change beyond that, and I would repeat, my support for the basic choice of looking at extended retirement age as one of those items needed to put in for structural reform needed when the time comes that the predictably large group of persons born in the 1950's and 1960's will be coming up for retirement in the next century. I also think that the committee may well want to look at an alternative which would possibly have a little less political explosivity to it, but which would also deal with the same need for basic structural change and be ready when the large number of beneficiaries come into the scene. That change would be one of reducing the percentages in the so-called PIA benefit formula—the personal insurance amount—which currently are 90 percent, 32 percent, and 15 percent, by a 5-percent factor relative to all three over an 8-year period from say 1990 to 1998. Those PIA benefit formula numbers would ultimately be reduced down to 85.5, 30.4, and 14.3 percent, respectively. All of this would have the effect ultimately of reducing benefits in all cases, regardless of earnings history, by some 5 percent.

The kind of change that would be predictable, that could be put into effect far enough in advance to give warning to those who are going to retire would have perhaps a little less of the explosive or politically difficult features of the extension of the retirement age. As we could calculate it from the work of the Commission staff, this would have a long-term impact of 0.55 percent of payroll as against the 0.58 percent that we have identified in the report as being needed.

I suggest this only as an added factor for the committee's consideration when you come to that point, in which the Commission's report left really two directions to move forward. This may be one that the committee would like to look at in addition to, or perhaps in place of, the extension of the retirement age.

In summary, Mr. Chairman, this Commission's work, I think, has been remarkable. I think the fact that we have a 12-to-3 agreement gives the kind of bipartisan backing to a series of compromises which, as has been noted, brought difficulties for every member of the Commission. My reading of the business community is that there is a great deal of reassurance and relief, frankly, that the Commission came up with a consensus recommendation, plus the hope that the Congress will expeditiously put it into effect basically as recommended.

Thank you, sir.

Chairman ROSTENKOWSKI. Thank you, Mr. Trowbridge. I want to thank you all once again. It is the intention of the Chair to go through questions with members trying to work within the framework of the 5-minute rule. However, I realize that when a member of the committee is going to ask a question, the answer might take a little longer than 5 minutes, but we are going to try and work with some time constraints.

I would like to also inform the members of the Commission and the public generally that it is the intention of the Chair to work until 1 o'clock and to recess between 1 and 2, to resume our sitting for further questioning if that need be.

And I am sure that we will be in session after 2 o'clock.

Gentlemen and Ms. Fuller, the Commission's recommendations for a stabilizer regarding paying benefit increases based on the lower of wages or price does not take effect until 1988, and would only be triggered by a trust fund reserve of 20 percent or less. Why does your recommendation take effect only in 1988?

I am concerned about assurances. What assurances do we have that there will be no need for a lower of wages or price mechanism before then?

Mr. GREENSPAN. Mr. Chairman, I think that that was an element in which there was disagreement, and on which we struck a compromise, and I think perhaps the person best suited to answer that question would be Bob Ball.

Mr. BALL. Mr. Chairman, the trust funds are at a low point now, and you cannot build them up rapidly without major cuts in benefits or major increase in taxes. If you were to have that proposal go into effect in the very near term, it wouldn't be a backup stabilizer. It would be the same as saying that we will have wages or prices, whichever is the lower right now.

There are very strong objections to the idea of wages or prices, whichever is the lower, among a large number of groups that I think are important to this compromise. To have it go into effect as a back-up provision after the trust funds are built up to the 20-percent point—and hopefully never to be used—is hard for them to accept, but possible, whereas if you just put in wages or prices, whichever is the lower now, it would be one more very difficult hurdle for the proposal.

Chairman ROSTENKOWSKI. What you are saying is you expect it to build up, is that it, Mr. Ball?

Mr. BALL. Yes, this proposal doesn't go into effect until after you take into account the income as well as the outgo during the year 1988, when there is a tax increase.

Now, it isn't that this stabilizer is the only thing that we are relying on, as you know, Mr. Chairman. There is a proposal that interfund borrowing from hospital insurance be continued until the date that the stabilizer comes into effect, plus, we are all agreed that underlying everything else we need a fail-safe proposal.

There is a difference of opinion as to what it should be, but there is an agreement that we need something in addition to those two provisions agreed upon. In our case—the five of us appointed by Democrats—we favor a proposal granting the authority to borrow from general revenues or to issue bonds as a final back-up provision.

Chairman ROSTENKOWSKI. Thank you, Mr. Ball. If more recent estimates of the short-range deficit prove to be substantially greater than the $168 billion your package saves, what can you recommend the Congress do to make up the difference, and still retain that fragile bipartisan support?

Mr. BALL. Mr. Chairman, I have no basis for second-guessing this agreement. It seems to me that there is every likelihood that the proposals as they are will be sufficient, and obviously with a fail-safe provision they can't help but be sufficient.

There is no way that there is a problem, if you have authority, say, to borrow from general revenues until the period in the 1990's, where I think there is now agreement that—given this kind of a stabilizer going into effect in 1988—there is going to be a large build-up in the funds. I think there is now agreement on that, once you have this stabilizer in effect in 1988. So it seems to me that the fail-safe arrangement, in the unlikely event that the other proposals are not adequate, carries you into the 1990's, when any borrowing can easily be repaid.

Chairman ROSTENKOWSKI. Mr. Conable.

Mr. CONABLE. Thank you.

Mr. Ball, in effect, you are saying then that there was sufficient sensitivity about changing the COLA so that you put off any possibility of a change until such time as you thought it would not be necessary. Is that generally it?

Mr. BALL. That sounds pretty good to me, yes. After all, a stabilizer isn't supposed to be a cloak under which you make a change in benefits. It is just what it says. You don't want to put it into effect until you have a likelihood at least, of its not being triggered.

Mr. CONABLE. I understand that, but as a Commissioner who heard both viewpoints, you certainly won't deny the importance of having a stabilizer.

Mr. BALL. Oh, on the contrary. No, I think it is very important.

Mr. CONABLE. So that although it may not be needed at the time it takes effect, it still becomes a very important part of the assurance to young people that there will be a stable fund in the future, regardless of our ability to predict it?

Mr. **Ball**. Absolutely, Mr. Conable. I think it would be a great mistake for us to go on into the future on the basis of any single set of estimates. It seems to me that we may have differing degrees of confidence in different estimates, but that all of us should agree that none are infalible, and that we need the three different things that we have proposed underlying any set of projections.

Mr. **Conable**. I would like to consider with Chairman Greenspan the strategy of this proposal. It was discussed a great deal in the negotiating sessions of the Commission. Is there any part of this, Mr. Greenspan, that you think could be taken out and the compromise still preserve its essential outline?

Mr. **Greenspan**. I am certain if you press me for every single line and word, I might suggest that it is possible, but on anything substantive, anything which resembles a critical element in this negotiation, I would say no. We struggled very hard.

For example, take the question which the chairman just asked. It was not an arbitrary date. In fact, there was very considerable discussion in constructing precisely something upon which we could all agree, and I would go further to say that probably characterizes virtually every line in the agreement. I would caution anyone who believes that this is sort of a loose agreement which has capability of being reflected in various different parts, I would caution them to recall that we were at loggerheads up until the very last moment, and this is an extraordinary agreement in the sense that it is, I suspect, almost the only one on which the group of 12 out of the 15 could probably have been brought together.

Mr. **Conable**. In your long-standing capacity as an economist associated with the Government in various ways, have you made any effort to estimate what might happen if this agreement fails?

Mr. **Greenspan**. Yes, I have, and I might add that this is not an agreement which if I had written it from scratch and decided what I thought would be the optimum solution would have come out. Nonetheless, what I am aware of is the fact that the social security system has now become a critical symbol for the international financial community, not to mention our own, of how this Government is going to confront what is clearly a very severe budget problem.

In the event that somehow or by some means Congress fails to resolve this question in a way which is perceived to be adequate towards the long-term solution, I am most fearful that the international financial markets would take this as a terribly negative signal, that our domestic markets would perceive it is a verification of their already relative deep-seated view that the Federal budget is out of control, that it will create a reign of inflationary forces, and that that in turn perceived as it would as a major factor in the long run, would push long-term interest rates up from where they are, would abort a nascent recovery and I think create problems for this Nation which I have very great difficulty even contemplating.

Mr. **Conable**. We don't have the option of doing nothing. Have you any view of what might be the easy way out if the compromise falls apart?

Mr. **Greenspan**. No. I am fearful that Congress would do something, and what that something would be, I would presume would merely be some method of adversion to general revenues, which is a euphemism for printing money, and should that occur, irrespective of all the verbiage that surrounds the legislation, I am fearful that that would be a signal to the financial community that we are truly in a state of fiscal hemorrhage, and the financial markets would react accordingly, adversely to the economy in both the short and the long term.

Mr. CONABLE. Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Pickle may inquire.

Mr. PICKLE. Mr. Chairman, before you start timing me, may I make an observation to the Commission just for the purpose of the record? I said at the beginning your report is very helpful, and I don't think we would be this far along if you hadn't come together, so thank you for the contribution.

There are several unanswered areas in the report and I think we ought to list them, because in doing so, I want to be sure we are all aware, and if you have got a recommendation for us, to get that to us as we consider this legislation.

First, you do say there is a long-term deficit, and that is very important, just as important as the short-term package, but you don't say which way.

Now, you make references to raising the age or raising the taxes. I didn't hear anybody this morning say that you might also slow the growth of benefits. Is that in the report? Or more specifically to you, if you have got a recommendation, how you would do this in the long term, we would be glad to have it. I don't think we really need that, because five out of six this morning indicated you ought to raise the age.

Another problem unanswered is the short term, because Mr. Ball has just said that we may not have a short-term problem with this package. We ought not to try to second-guess, yet your own Commission, your Director, indicated that you very likely will have a short-term problem, that the figures are soft.

Now, if they are, in the short term we have got to raise additional funds, and all the report indicates is that you might have interfund borrowing. Your report makes general suggestions of general revenue borrowing, social security bonds, temporary benefit reductions or temporary tax increase, or interfund borrowing. If you have a recommendation for us to consider, either as a group or individually, I think the committee would recommend it.

You said that there is a shortage in the taxing—that there is a notch in the taxing of benefits, and you say that you recognize that, but you are sure that is an oversight that the Congress would rectify. That is a big help to us, but we recognize we do have a notch problem. If you have got a suggestion for how it should be done, we would like to receive it and receive it quickly.

The same is true of windfall benefits. You say that it should change so there is equity among Federal employees. We attempted to correct that in our bill 1½ years ago. I would like to ask you, do you leave that up to the Congress?

In connection, also, with the fail-safe, you also said that you would use that primarily to have interfund borrowing. I guess I answered that.

The stabilizer does not take effect until 1988. If I understand one of the panelists a few moments ago, and this is a question that Mr. Conable asked, if there is an additional short-term problem would you be willing to move the fail-safe aspect—that is the difference between the wages and prices—up to 1984, we will say? That is one question I would like to have.

You make reference in your report that there should be a supplemental retirement plan for the Federal employees based on the recommendations of changing it to cover new hires. This committee, of course, is not—does not have jurisdiction in that area. That would come from the Post Office and Civil Service Committee. If you have a recommendation as to how that should be done or if you have a feeling about it, I would like to have it.

Also, the last observation I would make is this, the Commission clearly indicates that we should have interfund borrowing. You make that as a recommendation. But I don't notice that you said anything how it should be repaid except you made reference that it ought to be repaid if feasible.

I would like to have something more specific from you than that.

When we passed the interfund borrowing we clearly provided that it be repaid with interest. I assume that to be your position but if either of you want to respond, fine.

Now, Mr. Chairman, let me get to my questions.

I guess Mr. Greenspan would respond to this. You say the retirement age should be raised and it is inevitable and we ought to look at it as a retirement program and not a disability program. But you also say that we ought to have an expanded disability program provided for those people 62 or in that age.

You make reference to that strongly, that you ought to raise the age, but you have to have a disability program. But you don't say how you handle it, who would be covered, that type of thing. That is a big gap in there and I would like you to respond.

What kind of disability program do you have in mind? Do you have a program you want to submit to us? How would it work?

Mr. GREENSPAN. Mr. Pickle, what I was referring to basically was to find a mechanism which addresses what is a new group in the disability system under extended normal retirement, those who were under the OASI program in the earlier period but now would not be. I don't have specific recommendations other than to specify it should address the problem.

The only point I would make is to emphasize that the issue is not a retirement question, it is a disability question, and I would not consider myself an expert in the disability system and would hesitate to recommend anything more concrete than just a general principle of where I thought the emphasis should be.

Mr. PICKLE. But we don't do it on general principle.

Mr. GREENSPAN. I would assume if one wanted to and someone gave you the task to do it, we could come up with it, but I don't think that with the exception of Mr. Ball or Mr. Beck to a somewhat different extent, that any of the Commission members are specifically expert in the particular specific technicalities of that.

Mr. PICKLE. If you do have a suggestion about it, you make reference to the fact that we ought to give consideration. If the age is raised and reduction is made, that is a reduction in benefits, then we ought to be cognizant of the fact that also disability might increase.

I don't know how we would handle that. I think I would agree with you in concept, that we know how to handle it as we move along. I would like to have any further recommendation you may have.

With respect to the age, Mr. Ball, the Commission clearly said that we have a long-term deficit. And let me tell you that definitely that is very important that you made that finding.

Now, the question is how we go about it. Either raise the age or raise taxes or there is a possibility that you could slow the growth of benefits. Maybe even a combination would fit.

You said that we have a shortage long term, but you also said that we ought not to try—that we don't know that—that we are not certain 20 or 25 years from now. We ought not worry about that too much, we can do it later and you would leave that to future Congresses.

Now, when you said that that concerned me because you know on the one hand you admit we have a long-term deficit and it ought to be corrected. But you say that maybe we don't have to do that except by raising taxes later; your official report said that, of course.

But you would do it by raising taxes, but you also say you wouldn't want to do it by raising the age. It seems to me like you are being inconsistent. You say on the one hand that we ought to solve the deficit problem and we ought to do it by raising taxes, but not by raising age.

Are you committed to the proposition that we have the long-term deficit and we ought to handle it some way?

Mr. BALL. Mr. Pickle, let me see if I can be clear about what my position is.

I fully support the agreement which is an attempt to reduce the 1.8 deficit all the way to zero. However, I think it is very important that the country understand that the agreed-upon package—without going to where we differ—that the agreed-upon package of the Commission reduces that long-range deficit by 1.22 percent. In other words, the great part of it is handled for the long term by these recommendations. That leaves 0.58.

Now, I just remind the committee that that 0.58, by itself, although I am for reducing it to zero, is not and has not been considered in the past to be a major matter. The usual way in which the trustees and Congress have considered long-range deficits is to say over a 75-year period, estimates are so uncertain that if you are plus or minus 5 percent of expenditures, you are in close actuarial balance. Now with the deficit at 0.58 you are in that close actuarial balance.

Don't misunderstand me, I still propose and urge you to reduce it to zero. That will help restore the confidence of the country in the program. I don't consider it the most important thing, that is all.

But my proposal for doing so and the proposal of all five who were selected by Democrats is to put in the law now—not leave to future Congresses—but to put in the law now an 0.46 percent point increase in contribution rate. The only thing that I said or meant to say about leaving it to future Congresses, was when I was critical of the automatic provision in the age 66 proposal where they are arguing not only that you put in age 66 but that the age be indexed to longevity and rise under the assumptions by 2055 to 68. I feel this program has enough automatic provisions in it now.

Mr. PICKLE. May I respond briefly and I want to ask you another question at this point, 0.58 long term, that is a mighty lot of money. It ought to be legislated upon.

Mr. BALL. I agree. That is part of the agreement.

Mr. PICKLE. But raising the age is another possibility. Wouldn't you agree, Mr. Ball, when we consider the social security solvency we must think in terms of the years down the road when our young people are coming of age and not just consider it as an appropriation for 1, 2, 5, 10 years? We must necessarily consider long-range actuarial estimates, do we not?

Mr. BALL. Of course in this Commission——

Mr. PICKLE. It seems to me we must do the whole job as we are doing it now.

Mr. BALL. I was emphasizing this Commission's recommendations do reduce the long term by 1.22 percent in the consensus agreement.

Chairman ROSTENKOWSKI. Mr. Rangel will inquire.

Mr. RANGEL. Thank you, Mr. Chairman.

Mr. Greenspan, what protections did the Commission provide for the new entry civil service employee after being incorporated into the social security system, to insure that his or her benefits will be equal to those civil service employees grandfathered into the pension system?

Mr. GREENSPAN. There is no guarantee other than the fact that the Commission was recommending that the Congress address that question. Dr. Meyers' memorandum which has been submitted for the record appropriately [illegible] what the Commission's specific recommendation was.

The total retirement system [illegible] the Federal Government including the OASI and the civil service pension funds is an extraordinarily complex system in [illegible] that one cannot and should not in fact endeavor to make recommendations in a form which would basically by inadvertence contradict certain characteristics of it. I think we are consciously endeavoring not to get to the precise mechanism by which a secondary civil service pension system would be constructed for the new hirees. Were the committee interested in our views, I am certain you would find a number of views roughly similar coming from the Commission members.

Mr. RANGEL. What you are saying, Dr. Greenspan, is that you certainly wanted to include new Federal employees into the system, but to protect their pension rights totally was too complex for the Commission and that the Congress should work that part out?

Mr. GREENSPAN. I would say that that issue was left largely moot. Some of the Commission members presumably would fully subscribe to that, some partly, some possibly not at all.

Mr. RANGEL. There is no question that the Commission agreed that something had to be done to supplement the social security projected pension fund.

Mr. GREENSPAN. That is certainly correct, and I think it is implicit if not explicit in various forms in which the recommendations were made.

Mr. RANGEL. Our congressional leaders are pushing for quick resolution of the recommendations made by this bipartisan committee, but it doesn't really give us any answers for those people who ask us—and rightly so—what protections do we have now that we are leaving the civil service pension system or at least in part, and going into the social security system.

Mr. GREENSPAN. I must say that not leaving it—they have not arrived yet. These are new hires only and the question is really——

Mr. RANGEL. We have a two-class system and——

Mr. CONABLE. January 1, 1984.

Mr. GREENSPAN. The point is——

Mr. RANGEL. Would that take care of the problem because it is 1984?

Mr. CONABLE. No, but it gives the Congress time to work on the system. It doesn't take care of the problem but the problem doesn't exist with respect to specific people now. It is only people hired after that time that will be covered.

Therefore, we would not be making any misrepresentation to them.

Mr. RANGEL. You are counting their money in before we work out a package.

Mr. CONABLE. We assume the Government will go on hiring people.

Mr. RANGEL. Thank you for the nonanswer. I guess we will go to another committee and ask them to supplement the work of Ways and Means because we don't have jurisdiction over that part of the protection package.

Chairman ROSTENKOWSKI. Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman.

Did any member of the Commission know anything about, or discover, what the secret plan was we heard so much about last fall to destroy the social security system? Did you hear about that or do you know anything about it?

We heard a lot in November and October that there was a secret plan to destroy the social security system. Did any member know anything about that?

Mr. GREENSPAN. I must say, Mr. Duncan, I read about that and you know you are often in possession of certain knowledge that certain things are untrue. It is rare. That happens to be one of them.

Mr. DUNCAN. Would you like to respond to that, Mr. Ball? I think one of your group was saying there was a secret plan.

Mr. BALL. I know of no such secret plan, Mr. Duncan.

Mr. DUNCAN. Also, last fall we were hearing from responsible voices that there was nothing wrong with the system, that it was sound and nothing should be done, just leave it alone; any of you agree with that assumption?

Mr. BALL. I don't know about people who were saying that, Mr. Duncan.

Mr. DUNCAN. It is in the record from responsible leaders.

Mr. BALL. Certainly I never did.

Mr. **Duncan**. The estimated long-term savings of 60 percent of payroll resulting from the provision of tax benefits is based on the assumption that there will be no increase in the tax threshold over the next 75 years. This means that before many years elapse we will be taxing social security beneficiaries who will be perhaps in the lower range of personal income.

How realistic do you think it is to assume that we would not exercise or increase these tax thresholds? Does anyone wish to comment?

Mr. **Ball**. Mr. Duncan, if you would permit me to—before I come right to your question—to back up on the rationale of this proposal; I would like to do that.

Mr. **Duncan**. Yes, sir.

Mr. **Ball**. The treatment of social security under the income tax is the exception, not the way retirement income is generally treated.

As you all know, retirement income is usually taxable in the income tax after the employee has recovered whatever he or she has paid toward the retirement benefit exclusive of interest.

So that an employer-paid-for pension plan is entirely taxable as soon as the individual starts to receive it, civil service is taxable in full once you have gotten back what you yourself have paid in, usually in 2 or 3 years.

Now, social security has been an exception to that by reason of an early Treasury ruling. It is not legislative at all. In the early days the Treasury made what I think was a mistake in ruling that social security was a gratuity, that people had not paid for it, that it just came out of the Government and that since gratuities are not taxable to the receiver, they ruled that social security benefits were not taxable.

Now, I think that the Commission felt that you couldn't sustain that attitude toward relatively high income people who are receiving social security and have substantial other income in addition, that that exceptional treatment of social security retirement income as compared to all others ought not apply to them.

Gradually under this proposal—as you suggest, it is not indexed—the thresholds would bite less and less so that people of somewhat lower real incomes would begin to add half their social security benefit to the taxed portion of their incomes. It is limited to one-half on the assumption that half the benefit is from the employer contribution and half the employee, and the half from the employee has been taxed throughout the worker's life.

But the employers side has never been taxed. I am speaking now only for myself and the Commission did not address this, but a gradual, very gradual inclusion of half the benefit in taxation at lower thresholds because of change in the value of money would not be upsetting to me.

You asked me a practical political question, will the thresholds get changed. You would be much better able to answer than I am.

Mr. **Duncan**. Thank you. I have no further questions, Mr. Chairman.

Mr. **Pickle** [presiding]. Mr. Stark.

Mr. **Stark**. Thank you, Mr. Chairman.

I would like to commend the panel and the Commission for showing us that there is a possible bipartisan compromise on this and for setting a goal for this committee to come out with a program that we can agree to. But I wanted to address a question to Mr. Ball, and if anyone else wants to chime in, fine.

I have some concerns, and I wonder whether this was addressed, now that the panel's report is issued, that we may see municipalities and nonprofit groups withdrawing very quickly from the program, and it will be my intention to, if no one else does, to offer an amendment that whatever bill comes out take effect January 15. I wonder if the panel considered retroactivity at all in their discussion?

Mr. BALL. Mr. Stark, as far as nonprofit employees are concerned, the recommendation is for mandatory universal coverage so that there can be no withdrawal of anybody. They are covered.

Mr. STARK. Even very small nonprofit groups?

Mr. BALL. Yes, 85 percent are already covered. This is 15 percent now that have not come in under the semivoluntary arrangements in present law.

Mr. STARK. I keep hearing about the constitutional arguments on city and State employees.

Mr. BALL. I was going——

Mr. STARK. What really is that? It seems to me somewhat unfair. Los Angeles County with 55,000 employees just opted out and Alameda County may well stay in. It somehow doesn't seem fair.

What is that constitutional argument?

Mr. BALL. The argument, sir, and I am obviously no expert, but the argument has been as to whether the Federal Government had the right to impose a tax—and the social security contribution is technically a tax—impose a tax on the State. Because of that situation where it might be unconstitutional, the arrangements have been set up on a voluntary basis where the State or locality has to agree to come in and if they already have a retirement system, they conduct an employee election, also.

One thing that seems quite unfair is if the employer decides to terminate, there is no election. It is just a decision of the employing entity.

But to answer your other question, Mr. Stark, the proposal of the Commission dealing with State and local groups that are already covered is to remove the option for them to withdraw and to do so in such a way that unless the process has been completed by enactment date, unless the withdrawal has been actually completed, pending notices would not be effective.

Mr. STARK. What you are telling me is that, under your recommendation, we could prohibit future withdrawals but we couldn't force previous withdrawals back in? Is that the catch-22 we are in?

Mr. BALL. That is the position of some constitutional lawyers.

Mr. STARK. I would welcome at any time, whatever, if constitutional geniuses can dream up something. That seems very unfair to me. Do you have any figures on what the benefit would be if we get all State and municipal employees in?

Mr. BALL. It is not within the Commission's agreement but I don't think it is any violation or real extension of it to say that you might want to consider, for the groups who have withdrawn successfully, the opportunity to come back in again on a voluntary basis.

I don't know whether you want to do that or not. Surely you don't want to do it more than once.

Mr. STARK. In Mr. Meyers' memo that he circulated today, the figure is quoted that 80 percent of our civil service retirees aged 62 or over are also eligible for at least some social security.

Did the panel consider this, and, if so, could you comment on this, on not allowing someone to qualify for some level of benefits and then work in another noncovered occupation for some number of years, say work 10 years, then work for the Federal Government 10 years, but still have locked-in benefits and not pay for the entire course of their working life?

Was that considered?

Do you have numbers on that?

Mr. BALL. There is a proposal by the Commission, Mr. Stark, that deals with the problem that you are addressing—that is, the fact that a person who spends a large part of his career in something like the Federal civil service that is not covered under social security can pick up social security coverage at what amounts to bargain rates. They get the advantage of the weighted-benefit formula, not just the minimum benefit, but the weighted benefit that really is intended for low-paid people.

Mr. Pickle, in his listing the unsettled questions, pointed out that in our report we say there are two ways you could do this, and we recommend that you do do it.

I must say that, to address yours and Mr. Pickle's question, I think the practical way is the way that is described in our report of not having the first factor, the 90-percent factor, apply in such cases. Start at 32 percent.

The other proposal we make is really more exact but the trouble is that the Social Security Administration doesn't have available to it the records of noncovered employment that would be necessary to carry out our other recommendation. So, probably rough justice is done better by the proposal that says figure it at the 32-percent and 15-percent rate.

Mr. STARK. Thank you very much.

Thank you, Mr. Chairman.

Mr. PICKLE. Mr. Jacobs.

Mr. JACOBS. Mr. Greenspan, in the wee small hours of the morning of January 1, 1983, when your Commission struggled on into a new birth or new life, a significant growth in social security benefits also occurred. I know your Commission is concerned not only with the growth in the tax but also the growth in the benefits that has occurred during the past several years.

But my question is, When you contemplated the denial of the cost-of-living adjustment for 6 months, did you give any consideration to the repeal of the retirement test which occurred January 1 of this year for those 70 years or older?

Mr. GREENSPAN. Yes, we did. I think that was an issue which was discussed early in the Commission proceedings; subsequently, it ended up as not being an element involved in the final compromise.

Mr. JACOBS. That bothers me, there is an old song about the rich get richer and the poor get poorer. Do you subscribe to the apparent logic of the proposition that retirement benefits ought only be paid to those who are retired?

Mr. GREENSPAN. Mr. Jacobs, you are raising a broader question which really gets down to the question of, Do we have, fundamentally, an insurance system in which what one receives reflects what one pays back?

Unquestionably if what we have is an actuarily, fully funded system, then, clearly, one should receive benefits irrespective of whether one is working or not working.

However, one of the interesting complexities of any social insurance system is that it has certain welfare characteristics associated with it. In my judgment, at least, the reason why that surfaces in the first place is to capture that question. It is an incongruity which I think is built into the system that we have set up.

One must recognize that.

Mr. JACOBS. But we are here to question some of the elements that are built into the system. Your Commission, as I understand it, was appointed to seek out marginal benefits that were burdensome to the system and, as the musician Andrew Martin said, "It is difficult for six people to carry a piano, but it is especially difficult if one of the biggest ones is riding on it."

Now, you have here a situation where a person, a lawyer, a doctor, a professional person, business person, would have an income of $300,000 or $400,000 a year and still, as of January 1, 1983, receive what is commonly called golf cart money and social security benefits.

True, that person paid into the program; but was there ever a time when the retirement test was not a part of the social security system from the year 1935 when the act was passed? Does anybody know the answer to that?

Mr. BALL. Whether it was?

Mr. JACOBS. Was not the requirement test built into the system at the very beginning.

Mr. BALL. Yes.

Mr. JACOBS. Mr. Beck, didn't your group and Mr. Trowbridge, didn't your group object to this liberalization of benefits at this dark hour for the social security trust funds in your testimony within the last couple of years before this subcommittee?

Mr. BECK. Yes, that is correct.

Mr. JACOBS. Thank you.

Mr. BECK. I objected—just to complete the story—because at a time we were looking to put the social security system back into financial balance any liberalization was one that we would speak against.

Mr. JACOBS. I would just say for the record, Mr. Chairman—and I direct my remarks to the chairman of our subcommittee—that in terms of public confidence and public faith and fairness in the social security system itself and the vast, vast majority of people who are paying their taxes in at present and never will be in that position of having handsome earned income at the age of 70, I think that serious consideration ought to be given, and I know your package is together and I am not asking you to amend your package, but it seems to me it might be trued up a tad by asking the extremely well off to take a little bit of this sacrifice also.

Mr. BALL. Mr. Jacobs, I have two or three comments if I could on what you have said.

One is, most fundamentally I disagree with Mr. Greenspan that if you had a strict insurance system you couldn't have a retirement test. Depends on what it is insurance against. It doesn't have to be an annuity at a specified age. It could be insurance against loss of income in retirement after a given age.

That is what the system has been conceived of and I am for retaining it that way. I am not for abolishing the test.

I would have personally pressed for the retention of the age 72 rather than let the age drop down to 70. That is a personal opinion. The problem that there was no time for Congress to act. The age 70 already is in effect and I think it would be unwise now to turn it around.

Mr. JACOBS. We don't have to collect anything that was paid, but we can stop paying. I never heard of an insurance policy that didn't have certain conditions for payment of proceeds.

One of the conditions of this, call it an insurance policy or whatever, from the day it was passed, was that in order to get retirement benefits, you must be retired.

Now, there is a ring of logic to me in that.

Mr. BALL. We have helped in one respect and that is by including the proposal for the taxation of benefits for higher income people.

Mr. JACOBS. Peace.

Mr. PICKLE. The Chair recognizes the gentleman from Texas, Mr. Archer.

Mr. ARCHER. Thank you, Mr. Chairman.

As a member of the Commission, I hope the Chair will be lenient with me as to time inasmuch as I am not sitting as a witness to make my comments from that position.

I have a number of things I would like to air.

First of all, I would commend the Commission and also say that I have gained a great deal of respect for my fellow members of the Commission over the past year, all of them. That is without exception.

It has been a real pleasure and a privilege to serve on the Commission with each and every one of you.

I think the Commission has done excellent work, if in no other way than to define the problem so that the Nation can focus on it and begin to understand that we must take action.

I must say that I do leave the majority and I did vote against the Commission's report for a number of reasons.

They were stated succinctly in my separate views and I will not prevail on the committee or the members of the Commission to go back over them in detail at this time.

I do want to explore some basic predicates for this decisionmaking process and some of the basics of the decision itself.

I want to thank my colleague, Joe Waggoner, for what I thought was an excellent presentation and one which I associate myself with, and that prevents me from having to go back over a lot of it, Joe, and it saves the committee time.

I think we are very, very fortunate to have on the committee a man of Bob Beck's caliber who understands actuarial projections and the insurance business and certainly we need to have a background in that if we are going to attempt to have basic structural reform in social security.

For the record, Bob, I wonder if you would tell the committee what your actuaries project as the percent of payroll that will be required 50 years from now to maintain the benefit structure that will survive under the Commission's recommendations?

Mr. Beck. Well, our projections for the costs to maintain the system, including medicare, would require a total payroll tax for both the employer and the employee combined of somewhere between 25 or 30 percent.

Mr. Archer. At one point you mentioned to me during the deliberations that it could be as high as 30 to 40 percent. Has that now been scaled back?

Mr. Beck. No, I used 25 to 30, Bill.

Let me check with my other actuary with me.

It is 28 for OASDHI, plus the equivalent of 5 for SMI for a total of 33 percent.

Mr. Archer. So that is more than double the amount of taxation that we are contemplating in this Commission recommendation, admittedly including HI, which the Commission did not evaluate. But the payer of the benefits and receiver of the benefits considers HI to be an integral part of the social security, of course.

Now, I also notice from the actuaries' projections that the cost just to maintain the survivorship and old-age retirement portion of social security which was within our purview, not including disability, not including HI, will run to over 15 percent of payroll by itself fifty years from now.

And yet the only tax for OASI recommended by the Commission for this entire period is a tax of 10.2 percent of payroll for the OASI portion of it.

That is a 5-percent-of-payroll shortfall. Fifty years from now it is not going to be just 1.8 percent of payroll that we have to fill, assuming that these projections are correct—and I would like to get to that in a moment—it is over 5 percent of payroll that we are going to have to fill.

Now, admittedly during the interim the fund supposedly will accrue additional balances so that the 75-year projected loss is only 1.8.

But I submit to you that as of the year 2030, which is less than 50 years from now that it will be 5 percent short in the payroll tax that the Commission is recommending.

Now, let's also look at the actuaries' projections. We have heard two different comments about them, actually more than two but variations of two. Joe Waggonner says he thinks they are optimistic. Bob Ball thinks they are pessimistic.

I suppose Alan Greenspan basically thinks they are realistic.

I don't want to put words in your mouths, but that is sort of a feel that I get from your testimony.

Mr. Greenspan. Yes, I do, Bill.

Mr. Archer. Is that correct?

Mr. **Ball**. I accept 1.8 as a reasonable guess. I am not arguing that.

Mr. **Archer**. You think the intermediate projections are relatively optimistic.

Mr. **Ball**. No.

Mr. **Archer**. It is a point I have argued with the actuaries over the past 10 years and up to this point I have been right and they have been wrong; maybe the future will hold a different result, but my track record is very good up to this point. They were overly optimistic.

Let's look at those for the benefit of the public.

The actuaries offer us four different selections and the Commission created a fifth one which I will get to.

The actuaries offer an optimistic, an intermediate, and a pessimistic projection.

The Commission felt that to have a little better range we should look at what we perhaps loosely called our worst case assumptions, which were more pessimistic than the pessimistic assumptions.

I asked the question continuously and I don't need an answer today because it came back loud and clear throughout the entire hearings of the Commission, whether the last 3 years of actual experience was worse than the worst case assumptions and I was told yes.

Now, actual experience over the past 3 years admittedly has not been real good, but there has to be something that could be worse. If you look at a full range of projections on this, you have to consider that I am not predicting something worse, but I have to say in reality there could be something worse. If the actual experience is worse than the worst case, there is something wrong with our range of predictions.

It leads me to believe that the intermediate, as Joe Waggonner said, is not just realistic, it is overly optimistic if you look at the complete range.

We have done this year after year after year in social security deliberations. We have said intermediate, because it is between optimistic and pessimistic, is therefore realistic but it has not been realistic. It has been overly optimistic.

I say to you that today we are launching out on the same course, particularly for the long term. I don't think we have done enough to shore up this program.

Let me get in some other areas here. I heard the comment made that what we searched for was balance. Well, what is balance?

Mary Fuller said, accurately so, we have enacted $300 billion of new taxes to shore up social security between now and the end of this decade. We are putting what we do here on top of that. What does this proposal do in the name of balance?

It restricts the growth and outflow by $40 billion, and Bob Ball, I think accurately, presented his comments on the basis that we should look at the new income into the fund and the outflow and that is the basis on which we should look at our judgments.

I agree.

The new income into the fund is $128 billion in this proposal and the restriction restraint on outflow is $40 billion. If that is balance, then I didn't learn how to read and write and add in elementary school.

I don't consider that to be balance.

I read the Commission's report and I took exception to this in my dissenting remarks and here is what it has on the first page:

"We agree that we should not alter the fundamental structure of the social security system or undermine its fundamental principles."

Now, to me that means, as my friend Alan Greenspan says, that we should have a rough connection between benefits and taxes paid in.

I agree totally. That we should base the benefits on the taxes paid in. Perhaps they will be skewed a little bit, but it should be based on the taxes paid in. That is equity and fairness, that is what the American people believe in, as I read the American people.

We have moved dramatically away from that basic structural foundation of social security in this Commission proposal—more than at any time in the entire life of social security.

How can we deliberately say we have not altered the fundamental structure of social security when we establish for the first time a means test, albeit a back door means test as to what benefits will be, by taxing benefits and having a floor of $20,000 of outside income.

That is a fundamental departure from the traditional structure of social security. How can we say we have protected its fundamental principles when one of those principles is parity between employer in employee in the taxes paid in and we have ruptured that for the first time by the refundable tax credit which, Mary, you disagreed with and certainly I totally disagree with?

How can we say we maintained the fundamental structure when we dipped into General Treasury funds which I know many have wanted to do for many years and which I have attempted to fight over the years, which ultimately destroys the character of social security and leads us on the path to making it a general welfare program?

Let me cite to you where we dipped in the General Treasury. We have accommodated the social security fund by a loss to the General Treasury of $74 billion. This is in the short run. That is almost 50 percent of closing this gap of $168 or $169 billion.

You know where they are. I can list them for you:

Coverage of Federal employees, $8.5 billion out of the General Treasury.

Taxation of benefits, $30 billion out of the General Treasury.

Refundable tax credit for employees, $4.5 billion.

Increased tax on self-employed with a deduction for half of it which comes out of the General Treasury, $12 billion.

Gratuitous wage credit out of the military budget of $18 billion, a direct transfer of General Treasury funds into social security.

You can say all of this is justified in one way or another but face the fact that this comes out of the Treasury and then you can add on the increase of the $20 to $50 set-aside for SSI, which is another $4.5 billion in this period of time and you come up with $77 billion of accommodation out of the General Treasury.

I, for one, cannot say we have not changed the structural character of social security when all of these things have been done.

Mr. PICKLE. The time of the gentleman has expired.

Mr. ARCHER. I just want equal time with the members of the Commission if I may. It is very important, I think, this be put on the record.

Mr. PICKLE. I would agree with the gentleman and I ask the gentleman be mindful that we have other members waiting for questions. I know you are a member of the Commission, but——

Mr. ARCHER. I apologize, Mr. Chairman, but this is important.

Mr. PICKLE. I will continue to recognize you, but I ask that you be brief.

Mr. ARCHER. The Commission basically said let's tax benefits. This is a matter of overall tax policy that is extremely complicated and involves an interchange among an awful lot of factors having nothing to do with social security. By setting a floor of $20,000, you are not taxing benefits, you are taxing savings. At what rate? Did the Commission decide because to my knowledge it did not, at what rate these benefits would be taxed?

Will they be taxed at the base rate? At the highest marginal rate for each individual income taxpayer?

Mr. Chairman, was there a decision made relative to that particular point?

Mr. GREENSPAN. We all agreed to the highest marginal rate.

Mr. ARCHER. So what you do is shove savings into the highest marginal rate for taxation purposes and for those people who have put aside through IRA's and other means which we have encouraged, with social security considered as a supplementary source of income, we are going to say, if you put aside now, you will be penalized, but if you haven't, you don't get taxed. It is a strange anomaly to me.

In addition, I know already from talking with a number of tax consultants that they are getting ready and actively preparing for means to dodge this. This is a part of the tax policy the Commission didn't consider. By investing in municipal bonds, et cetera, available to people with $20,000 of outside income, and believe me, that will be done, they will avoid the tax.

I don't think there was adequate consideration on the part of the Commission of various things, including the notch problem which we deliberately say is easily taken care of by the Congress, but the Commission didn't come up with anything.

I worry a little about simplistic answers without adequate in-depth evaluation.

But, more importantly, I worry about the fact that we have not taken this opportunity to structurally reform social security so that it is truly credible for the young and the old alike.

I know many of you agree with me on the panel.

It is too bad in my opinion that we operated for noncontroversy rather than what was right for structural, fair, and equitable reform.

That basically, I think, was the decision. What can we get that is the most noncontroversial that we believe can find political acceptance?

I regret that I have to take this position, but I am more concerned about the future of my children and their children than to operate for what is purely a political decision and, Mr. Chairman, I hope that we will be able to improve this package.

I understand it is supposed to be inviolable and not one comma is supposed to be changed, but I intend to try to improve it so I will be able to say to future generations, we have done something you can rely on.

Thank you very much.

Mr. PICKLE. Thank you, Mr. Archer.

The Chair recognizes Mr. Jacobs

Mr. JACOBS. Thank you, Mr. Chairman.

I want to follow up just a moment on a couple of questions that have been concerning me that Mr. Archer has touched upon. I recognize certainly that the Commission had an extremely difficult task and I know that you considered the likelihood of passage undoubtedly when you made your final decision, but it is true, is it not, that we have—going to the taxation of benefits and having that total amount allocated to the trust fund—that we have for the first time encroached into general revenue financing for social security; isn't that correct? Is this the first time we have done that? If we adopt this, that is?

Mr. GREENSPAN. Technically, it depends on how you define general revenues. In the technical sense, there are general revenues that go into the fund for past military service benefits and a variety of other things, but I think the more important question is, how does one define the question or raise the issue of taxing of benefits? What is it, and basically what I thought was quite interesting about our discussions is that some of us looked at it as a net reduction in benefits; others looked at it as an issue of taxation.

That is why there has been a considerable amount of difference in the classification of the various elements in this package as a "tax" or as a "nontax" or "benefit cut" or something else.

Mr. JACOBS. If I can interrupt there, it does not bother me whatever as far as the taxation of benefits whether it is 50 percent, 75 percent, or 100 percent.

What bothers me is the allocation from the general fund over to the trust fund. This is a way simply to get allocation from the general fund to raise money for the trust fund, is it not?

Mr. GREENSPAN. No, I would disagree. I would say more likely it is a mechanism through which you can say you are reducing benefits.

Assume, for example, that what we are dealing with is an issue of withholding at source and supposing, rather than tax the benefits, we had a withholding tax which was effectively equal to what that tax would be. The question is, how should a recipient interpret the receipt of those particular benefits and it is a bookkeeping question.

There are those of us who look at this in different ways.

We have all agreed on the substance of the issue on the policy question, but we all view it in a different form and I would not view it as an invasion of general revenues, nor in fact as a tax.

Mr. **Jacobs**. If you view it as a reduction in benefits by viewing it in that context, of course, you have gone to a needs based system on social security, is that correct?

Mr. **Greenspan**. That is correct, but remember our system is already partially needs-based. It is a question of degree and if we were to discuss in great detail every one of these issues on which we have all agreed as part of the package and we were required to block out the fact that we all see the greater good in this total package as distinct from the parts, I am sure we can raise issues of what is wrong with doing every one of these individual things.

Mr. **Jacobs**. Let me ask you a further question. My time is about up.

Mr. Greenspan, in looking back in 1977, for example, and I supported the 1977 bill that raised substantial taxes to shore us up, and I know that the people of the Commission, including Mr. Ball and most Members of Congress, were sold on the idea that this was adequate—I was looking at your testimony from 1977 and you were quite confident that there would not be any difficulties beyond the year 2000. I am not saying that you stood alone, but I just re-read your testimony.

Now, the point I am trying to make—before I go down this path this time, is how sure are you now that this is adequate through 2020, I believe you testified to.

Mr. **Ball**. Mr. Jacobs, first of all, at the end of the 1977 amendments the Congress deliberately left a large long-range deficit—1.4 percent of payroll was left as a deficit.

Mr. **Jacobs**. Long range?

Mr. **Ball**. Long range, at the end of the 1977 amendments.

There was not the feeling that there is apparently now that you need to drive that down to a zero figure. The 1.4 percent was way outside the traditional 5 percent of expenditures even. What was said was not that the system was sound for the 75 years over which the estimates were made, what was said about it was that for the first 50 years of that period, even considering the 1.4 deficit, it was adequately financed for that period, not the whole 75 years.

Mr. **Jacobs**. It was said that it was adequate through 1983 I would hope, 6 years down the road?

Mr. **Ball**. The short range in the 1977 amendments presents a different issue. The actuaries were very careful in saying that in the early years the margins were narrow. They expected to be able to make it, but they were relatively narrow margins.

You asked me what is the difference this time?

Mr. **Jacobs**. What I want to know, I am concerned about now, going down that road and whether everybody is right or wrong?

Mr. **Ball**. The differences this time are several.

One, the estimates are deliberately based on more pessimistic economic assumptions. We selected $150 to $200 billion on the basis of trying to be sure this time. If you were going to take a reasonably optimistic view of the economy, $75 billion is closer to what many of us think may really happen.

The second point is that we have agreed on three things that were not in the 1977 amendments, and they are protections against bad economic performance.

We are recommending a "stabilizer" at the beginning of 1988 interfund borrowing authority between now and 1988; and underlying it all an ultimate fail-safe provision that would handle the problem if we go outside of the relatively pessimistic economic assumptions used.

Chairman ROSTENKOWSKI. Mr. Downey will inquire.

Mr. DOWNEY. Thank you very much, Mr. Chairman. I want to thank the Commission for the fine work they put in.

I think they make our job that much easier and if I can get out of my office under the avalanche of letters from Federal employees, I suspect I may be able to explain this to some of my constituents.

Let me ask you first about the delay in the COLA because that concerns me.

Does the Commission or any of the panelists know how many seniors will fall under the poverty line as a result of this action and does the raising of the SSI disregard from $20 to $50 compensate for those low-income seniors?

Mr. BALL. Mr. Downey, several of us found this the most difficult part of the agreement to accept. I accepted it only because it was an essential point to the agreement.

It was very important that we also include the increase in the social security disregard from $20 to $50.

For those people affected by that, that is the dual beneficiaries who get both social security and supplemental security income, that provides complete protection. They will get more from SSI than they will lose by the social security COLA shift, but I don't want to minimize the fact that there are many people of very low income who would be eligible for SSI if they applied, but have not, or who are just above the very low SSI eligibility levels. These groups will be adversely affected by this change.

This is the one thing in the agreement that affects present beneficiaries or future benefit levels, other than the taxation of benefits that we previously discussed.

There are no reductions in replacement rates, no bend-point changes. In the agreed-upon changes, there are no cuts in the disguise of increased age at which you first get full benefits. So this is the one thing, the one place and some of us recommend it with reluctance.

Mr. DOWNEY. I understand that. I understand this is——

Mr. BALL. I don't know the exact figures though as to how many more would be brought below the official poverty line.

Mr. DOWNEY. Your guess is some people will slip below the poverty line.

Mr. BALL. Undoubtedly, although in many States you have to be considerably below the poverty line to qualify for SSI.

Mr. DOWNEY. The figure of 20,000 as proposed—for taxation of benefits—why was that chosen as opposed to a higher figure? Were they revenue considerations, loss of benefit, the income level at which taxation of benefits begins?

Any one of you could respond.

Mr. BALL. We started with——

Mr. DOWNEY. Do we Democrats answer the Democrats? I will be happy to hear from some of the Republicans.

Mr. BALL. Fine.

Mr. **Greenspan**. Speaking for Mr. Ball, as I always like to do, as he was about to say, we actually started with a lower figure on which there was general agreement and the discussion about the impact of it eventually led us to a figure somewhat higher.

There is nothing sacrosanct about 20,000 or 25,000, and we couldn't argue between that and 22,000 or 27,000, or 18,000 and 23,000, but it is a number which, granted all of our various sensitivities, we found that we were able to fit our agreement into.

Mr. **Downey**. Can I ask—so, in other words, it was a figure selected; it was a figure not based on anything other than some revenue you have to raise as opposed to 21 or 22?

Mr. **Greenspan**. It is an obvious tradeoff. What we basically did was traded our view of where that trigger point was with the need to raise $168 billion.

Mr. **Downey**. Many of us are terribly concerned and upset that the supply side miracle offered to us in 1981 has not come to fruition; that the economy has not grown in the leaps and bounds that Messrs. Regan, Stockman, and Reagan predicted.

Are your assumptions for the economy more pessimistic or less so than those of Mr. Feldstein?

I think he predicts there shall be in the next 4 years 4 percent real growth as we come out of this recession. Are your assumptions more or less pessimistic than that?

Mr. **Greenspan**. I would say they are fairly close. This is a forecast coming out of the Council of Economic Advisors and by, in effect, out of the Government, which is not unrealistic.

Any forecast can be off by a wide margin, but to the extent one can characterize this forecast I don't consider it pessimistic or overly optimistic. If anything I would probably say it is a little bit low in the short-term, maybe a shade too high in the longer term, but it is an economist debating, and not a realistic discussion.

Mr. **Downey**. Thank you.

Mr. **Pickle**. The Chair recognizes Mr. Vander Jagt.

Mr. **Vander Jagt**. Thank you, Mr. Chairman. I would like to add my compliments to the members of the Commission who obviously studied long and some of you for a lifetime in that respect, with a great deal of experience and some very strong opinions on the subject of social security reform.

Considering the diversity of your backgrounds and philosophies and the great knowledge that each of you have, I think it is bordering on the miraculous that the Commission was able to reach consensus on a package.

Many of you have expressed how difficult it was to agree on a package. I think some of you said that if anyone had asked you 3 weeks before that it was possible, that you would have said no.

From your experience in wrestling with this subject, do you think if this package were to fail that there can be a political consensus built behind any other alternatives? Mr. Trowbridge.

Mr. **Trowbridge**. My guess, Congressman, is that it would probably not take place in sufficient time if at all. I think the forcing function that was really evident in those final days of mid-January when the negotiations were coming to a, to their end point, was a scenario which in effect said that if the Commission came up with a series of options and sort of scattered solutions we would be in fact telling Congress we couldn't solve it, you have got to solve it; and the Congress would then be debating through early May and miss the point by which legislation was required to effect the COLA delay from July onward, an essential part of the package in the view of many; and that having missed that point it would possibly be still debating in June at which point the funds having been borrowed in the interfund borrowing authority would have expired, and the checks began to go out later and later because the reserves were down too low.

You might have had a situation in which the President was confronted with a bailout proposition entirely using general revenue funds in a period when our deficits are already extraordinarily high and confronted with the choice of that versus checks going out too late, and the evaluation of that scenario was I think very much on the minds of all who were seeking a solution in the Commission to propose to the Congress imperfect though it may have been in the view of almost everyone.

Mr. VANDER JAGT. Your answer leads me to conclude that perhaps this is the only game in town, Mr. Trowbridge, in terms of our chances of saving the system at least as we know it. Obviously a massive bailout from the general revenue would not preserve the system as we know it. But that leads me to a question for any of you, about the nature of the package.

Mr. Conable alluded to this in his opening questions.

Several people used the word "fragile". How fragile is this package? I think every one of you has indicated there is something in the package you don't like and if you had the opportunity to write it yourself without relationship to anyone else, there is something that would come out of it.

Can we make substantive changes without having the package unravel? Who would like to take a shot at that? Mr. Beck?

Mr. BECK. I would like to, yes.

I am not sure how much opposition would come from other quarters but I know I had to wait until the very last instant before enough change was made that it permitted me to sign on. When we first began to discuss an agreement we did not have a stabilizer built into the system. I would never have signed on with an agreement that did not include that.

The early discussions had far too much in the way of tax accelerations which we believe would have had a very bad impact on the economy and on jobs.

Mr. VANDER JAGT. If the package itself is that fragile, we have heard all kinds of comments really, criticisms of the package—but we have heard the suggestion that well, the package could be supported conditioned upon something else, the elimination of the third year of the tax cut or elimination of indexing or a $40-billion reduction in defense.

Do any of you think that this package should in any way be conditioned upon any other action or is it a package that stands on its own?

Mr. BECK. It should be a package that stands alone, all by itself.

Mr. TROWBRIDGE. It shouldn't be a hostage to any other major decision, in my opinion.

Mr. **Ball**. I want to be clear, Mr. Vander Jagt, that I think it should not be connected with any other piece of legislation. I think it stands on its own. As I understand it, people who were thought to have made it contingent on something else clarified that they did not mean that.

Mr. **Greenspan**. Can I state why it is that this unusual situation exists?

If this were an agreement on the extension of benefits and the argument was who would receive what favorable treatment from the Congress on a specific type of legislation, it would be the type of agreement that is capable of being altered. When you are redistributing pluses, a positive sum game, you technically can vary those agreements no matter what you got because it is something plus for everybody.

This has the very peculiar characteristic of all of the individual components being negative. Nobody, none of us, like any of the individual items in and of themselves. We support them individually only as part of a total package which creates something of a very significant positive benefit; namely, it solves the problem of trust fund shortfall as we define it.

Therefore, it is very difficult to ask somebody to take on additional burdens. It is an asymmetrical type of problem. Therefore, it is as we have all said, fragile and I think we would unanimously recommend that it not be made contingent on any other aspect of the legislative process.

Mr. **Vander Jagt**. Thank you all very much.

Mr. **Waggonner**. Mr. Vander Jagt.

Mr. **Vander Jagt**. Fine, Mr. Waggonner has not had a chance to respond, Mr. Chairman.

Mr. **Waggonner**. On the subject of fragility, when you consider the state of our national economy, when you consider the state of State and local units of government and their economies, when you consider as well the sad state of the American businessman, large or small, when you consider the sad state of the economies worldwide, there is no way on God's blue canopy of heaven that you cannot consider this to be very, very, very, very fragile because these things do relate.

You cannot consider this in isolation from all other economies. Therefore, it is very, very, very fragile.

Mr. **Vander Jagt**. Thank you, thank you all.

Mr. **Pickle**. The Chair recognizes the gentleman from New Jersey, Mr. Guarini.

Mr. **Guarini**. Thank you, Mr. Chairman.

I recognize the almost impossible task you have had and you have done it very, very well.

But I have a sense of realization that the long-term financing is going to be very much in jeopardy. I have very little confidence in the basic economic assumptions generally made, although it is hard to project over a long period of time.

What bothers me is not that you don't have an economic solution but that nothing has been done to address some of the problems that are social problems. You have addressed economic problems perhaps quite well in many cases but the problems of women I don't think have been fully addressed.

The problems of people working and living longer which is a social problem has not been fully addressed. The social problems of the inequities and injustices in the system, which Ms. Fuller very well alluded to, have not been properly considered or fully considered.

And this is an opportunity of course that we have now but we won't have for many years to come. I am more or less wondering what your recommendation is as to long-range planning as far as an advisory Commission to continue or how should we procedurally address these problems in the future so we don't get into the situation we are in today?

I wonder whether Mr. Beck or Mr. Ball or any of you gentleman would have a comment?

Mr. BECK. In order not to stay with the practice of Democrats answering Democrats all the time, why don't I try?

I find it very hard to believe that this time around no matter what is done that we are going to solve all the problems of social security. We are going to have to look at this again and again.

I suspect that some of us who were working on it now will probably make this our life's work. Hopefully not all of the time, but for a good portion of it.

I suspect that the long-term need for increases in the retirement age is really greater than the number we have accepted, yet I have agreed to stay with the 1.8 percent of payroll even though recent fertility data would suggest the need is greater than that.

But for the sake of the agreement which does depend on everyone buying in for the whole package and for each of its parts, this is why I feel we at the very least must take care of that 0.58 percent of payroll with an increase in the retirement age, anticipating that the chances are very good in the future that we are going to have to go even further.

Ms. FULLER. I would like to say something on that.

I would like to make a comment that responds not only to your question but also to Mr. Vander Jagt's question, because I didn't get to do that.

Mr. GUARINI. I am concerned about the confidence and credibility of the system. As long as there are inequities out there it will crumble in the course of time. It won't stand on its own.

Ms. FULLER. I believe that major reforms are needed and like Mr. Beck, I was one of those who at the last moment signed on to a package that I thought fell short of meaningful reform in several areas.

The main thrust of the persuasion that caused me to sign on to it was that the feasibility of passing legislation in Congress in time to avert an emergency that would either delay the checks or cause a massive infusion of general revenues required a package that had a very heavy reliance on additional revenues and taxes in an effort to prevent beneficiaries from having to swallow an additional burden.

In my activities as a layperson—as far as the political process is concerned—and in discussions with people I come in contact with, I have a sense there has been a mood among the American people for balance, for reforms that would restrain benefit growth in areas like the retirement age where there is clear evidence of a need for it.

This kind of a feeling among the people would also support some of the fundamental structural reforms in areas such as earnings sharing, addressing problems that have to do with women's participation in the labor force and the higher divorce rate.

The counter arguments were essentially that the mood of the people from my microcosm isn't representative, that what goes on in Congress is something else, you know, or something that incorporates that but also incorporates it in a process that has a life of its own.

The arguments presented to me were the makeup of Congress at this time is such that this agreement was necessary in order to get legislation passed. That would avert an emergency further down the road.

One of the things I take away from this as it responds specifically to your question, how you do long-range planning, is that maybe intrinsic to the democratic process is a crisis mentality, it is easy as Dr. Greenspan——

Mr. GUARINI. It is agonizing.

Ms. FULLER. It is easy to distribute plusses, but the plusses you distributed 10 years ago are no longer affordable today. Now you will distribute minuses and it doesn't work in a democratic process unless you get so close to the emergency that something has to be done.

Mr. GUARINI. Do we have to condemn ourselves to that process in the future in social security?

Ms. FULLER. That is the question. Because it rests with Congress, I am least qualified in this room to respond to how better to get legislation through Congress, but that is where the will of the people is executed, here in the Congress.

I wish there were a way and I hope we can find a way to establish a group like this which is where decisions are made to impose a timetable that supplants this crisis mentality so all of these changes that would affect people on social security can be planned in advance. There has to be notice, which means they have to be thought out but not in an academic sense, they have to be thought out in a decisionmaking environment.

Mr. GUARINI. Does your recommendation have a mechanism so we may have a continuation of the thinking of a Commission?

Ms. FULLER. My sense, as somebody not at all involved in the congressional process which is where the action ends up, is that there needs to be a mandate from the legislature that says there will be a bill that addresses this problem. And it will be enacted in this particular session of Congress.

Now, this timetable should channel the inputs of the various parties to the debate.

Mr. GUARINI. My last point, if you would bear with me, Mr. Chairman, is it that we as a nation do not have a clear concept as to whether we are talking about a pension program or a supplemental program. There are people who think this is a pension system as it is their only way of income these days. But what started out as supplementary income now has gotten into the mindset of the people of America as a pension program.

I wonder whether we as a nation need to have this concept clarified as to which direction we are going and whether it is this ambiguity which is causing part of our problem? That is a philosophical concept.

Mr. **Greenspan**. It is a terribly important question to raise. Being someone who was not professionally involved in the social security dialogue until I came on board this Commission, of course, I was puzzled because I had a difficult time defining precisely what it is we were dealing with. It comes down directly to the question which you raise. I have no difficulty in understanding the mathematics of an actuarial system in insurance and funding and present value and all the procedures employed.

I have no difficulty with aid for dependent children or all the other various different welfare categories. This is an extraordinary amalgam in which seems to go on with a tremendous support from the American people, and yet it has characteristics which I think are fundamentally difficult to define and may well be unstable. And yet I am not terribly certain how one addresses this issue. And the reason why I think we came up with the conclusion that Mr. Ball raised early on here, leave it alone, is not that we are all satisfied that it was some perfectly functioning apparatus for reasons we all understood, but that the problem of dismantling it or altering it in a fundamental sense raised other problems which we all in one way or another considered of greater magnitude than the ones we perceived in the social security system overall.

How does one handle this thing, I don't really know. Maybe we need another commission.

Mr. **Pickle**. The time of the gentleman has expired.

Mr. Shannon.

Mr. **Shannon**. Thank you, Mr. Chairman.

Let me also say that I think the Commission did a remarkable job and I think you really presented us with a structure that we are likely to approve, at least as far as the short-term is concerned.

Having said that, let me say that I was a little disappointed, Dr. Greenspan, in the emphasis which you put on the long-term portion of the problem and the solution that you choose to adopt which is to raise the retirement age. It is my fear, frankly, that the debate which will likely ensue over this part of the problem weakens our efforts to get support for the more immediate part of the problem, and I am sure we are going to be discussing it very much.

Let me ask you this. While it is clear that life expectancies are going up, wouldn't raising the retirement age to 66 in fact be a benefit cut for those industrial workers and hard laborers who are not going to be able to work past the age of 62, 63, or 64?

Mr. **Greenspan**. First of all, Mr. Shannon, let me say that the fact that I emphasized in my written remarks the issue of retirement age was that in fact I fully support the short-term solutions as indeed we all do and the only issues as we see it as a Commission, those which are in fact debatable, are these two questions.

I think that——

Mr. **Shannon**. I appreciate that, and I assume that is the sentiment of the other Commissioners as well, Dr. Greenspan, but I think you are making an assumption that is not fair to make, and that is that the Congress embraced short-term financing solutions.

Mr. GREENSPAN. I certainly understand that.

Mr. SHANNON. We have a lot of work to do to be sure we have a majority of the House and Senate behind it. I hope you haven't lost sight of that.

Mr. GREENSPAN. On the contrary, oh, no, no, I am acutely aware having listened to the debate since our Commission report has come out that it is scarcely capable of being interpreted as embraced by the country. It is not. I think that it is an issue that clearly has to be clarified.

On the issue of the question of individuals who are in fact confronted with an increase in retirement age from 65 to, say, 66, 30 years from now, is it a benefit cut? Only if one talks in terms of relative to current law.

Do I think it is inequitable? No, I do not. I think as longevity proceeds it is a necessary stabilizing component of the total system that we attempt to maintain some rough ratio of the number of years in which a retiree receives benefits and the number of years which he or she puts moneys into the fund.

Mr. SHANNON. I certainly understand that argument from a purely financial solvency prespective. But while life expectancy has gone up I see no evidence that would indicate we can expect tremendous medical advances which are going to enable people in the 63-, 64-, or 65-year-old range to have any better ability to do those hard labor jobs which require so many people in those age ranges to retire now.

I wonder whether or not we are being inequitable to those people?

Mr. GREENSPAN. I would say if you look at the period especially 2010 or 2015, the number of people actually retiring from occupations of arduous labor will be very small.

Mr. SHANNON. That is an assumption you have to make in order to accept your proposal, and I have not seen the data which would back that up. We will certainly have an opportunity to discuss this further.

Mr. GREENSPAN. Sure. I would say even if it were not the case, I would argue one should not structure and craft an elaborate retirement system to address what I consider to be a special case.

Mr. SHANNON. Let me ask you and maybe all of the panelists except Mr. Waggonner and Mr. Ball, if this committee decides that, rather than raising the retirement age, we are going to put in a tax increase to solve that future problem, would any of you then withdraw your support for the proposal?

Mr. GREENSPAN. I have supported the fact of one or the other as such. In other words, I would prefer that that not be the case.

Mr. SHANNON. I understand what your preferences are, all of you, but the question is rather simple. Would you withdraw your support for the legislation if we go with a pure tax increase to solve that last portion of the problem?

Mr. BECK. My answer is no. Based on it that this was an open item, 1.8 has to be met, but how that last 0.58 is made, it is up for grabs and everybody fights for the one they prefer, but they don't withdraw their support.

Mr. SHANNON. Ms. Fuller.

Ms. Fuller. Well, my support was contingent on the fact that this was, (a) an open item, (b) it would be something that Congress would be asked to act on as opposed to not act on; and (c) that the majority of the Commission was going to be supporting a proposal to increase the retirement age.

It was never discussed with me on any other basis. Had it come to me with the long-term issue presolved with a tax increase, I would have to go back to the drawing board. I cannot say I would have supported it. But it wasn't presented to me.

Mr. Shannon. I am asking from here on. Assume we are going to buy the short-term financing package and just raise taxes to solve the long-term problem, would you support the legislation under those circumstances?

Ms. Fuller. The package was not presented that way. The package I voted for was not presented that way.

Mr. Shannon. That was always a possibility though, and I am asking if you assume that: What would you do?

Ms. Fuller. Well, I personally cannot agree with the tax increase.

Mr. Shannon. Mr. Trowbridge.

Ms. Fuller. I don't want to get boxed into having a simulated debate that never occurred because there were other people besides us involved in that debate at the time.

Mr. Shannon. I understand.

Mr. Trowbridge.

Mr. Trowbridge. Mr. Chairman, I voted with the majority in favor of the retirement age extension.

I mentioned in my earlier remarks that this committee might want to look at a third way, at the replacement rate question, which may well be less difficult politically than the retirement age extension, but which could, if structured and implemented with advance warning, do the same thing.

Mr. Shannon. That is an option I suppose we will consider, but I am assuming that we——

Mr. Trowbridge. My answer is, yes, I would support the package that comes through as we have described it in the committee report, both options being part of that package.

Mr. Shannon. Thank you.

Mr. Pickle. I have a question, but I will not interject them now along the same line because I think it is very important what we are discussing now.

The next person is Mr. Moore.

Mr. Moore. Thank you, Mr. Chairman.

I have but one question and Chairman Pickle of the Social Security Subcommittee asked this question, or made this point and no one on the Commission responded.

They responded to other questions.

I am concerned that we structure in the bill that comes out of this committee language providing for the repayment of the borrowings from the other trust funds with interest.

Does any member of this Commission have any objection as your report doesn't specifically touch on that, to us doing that?

Mr. Greenspan. No, I think it does imply that in the sense that if you look at the language we used for the stabilization mechanism it explicitly stipulates that the trust fund ratios are after repayment and I would presume that while—I don't think we have language in the report other than that it is my understanding that it is the view of the Commission's report that repayment is assumed.

Mr. MOORE. Thank you very much.

I wanted to get that on the record in case there is any question about that later.

Mr. BALL. Maybe it would help if I went on the record on that too. It was certainly my understanding that borrowing implied always repaying and at interest. I have no hesitation at all about that.

Mr. MOORE. Thank you very much. We are concerned about the future of the HI fund and we have problems with it. We really have problems if we don't repay what has been borrowed from it.

Thank you very much, Mr. Chairman. I have no further questions.

Chairman ROSTENKOWSKI. Mr. Thomas.

Mr. Campbell, if Mr. Thomas is not here.

Mr. CAMPBELL. Thank you, Mr. Chairman.

I would like to briefly say that I am very, very much in support of the general recommendations of the Commission.

That does not mean, of course, that I don't disgree with specifics just as each of you do.

I don't want to go back and explore the ground we have already gone through, but there is one item we have not talked about extensively and I would like to address this, beginning with Dr. Greenspan, to find out what the Commission's discussion may have been.

You have put in incentive. We talk about the possibility of raising the age of retirement. We talk about longevity, increased work life, so on.

You have put in an incentive from 3 to 8 percent for people working beyond the age of 65.

What discussion did you have on the disincentive of a 62-63 retirement time?

Mr. GREENSPAN. There was considerable discussion on that issue, but in the final crafting of the report it was not agreed to.

Mr. CAMPBELL. What is the percentage, Dr. Greenspan, if you know the figure, of the people now taking early retirement; that is, before age 65, eligible under social security?

Mr. BALL. Any time before 65, I think it is around 60 percent.

Mr. CAMPBELL. So a majority of the people are clearly taking retirement before the full age?

Mr. BALL. Right. That doesn't necessarily mean 62, you understand.

Mr. CAMPBELL. I understand. They are taking optional——

Mr. BALL. They may not have another job; it may not be an option.

Mr. CAMPBELL. I understand, but they are under the actual Social Security system.

Mr. BECK. Some estimates are higher than 60 percent.

Mr. CAMPBELL. I have seen them as high as 72.

Mr. BALL. That may be correct.

Mr. **Campbell**. The reason I want to pursue this is that as we go down the road and talk about increasing the retirement age, we talk about burden on the system of people drawing longer, the possibility and probability of trying to balance the amount they draw as opposed to what they pay in.

It seems to me that the encouragement is a disincentive at 62 but we have a COLA factor and that is a bonus. I wonder if you discussed any possibility of not disturbing the 8 percent? I think we are pretty well locked in, especially for the short period and I don't want to disrupt anyone, but I wonder if you discussed the corresponding reduction of COLA at an 8 percent level as a disincentive to the extent you did the incentive of going beyond 65.

I realize the 8 percent is a base reduction but it compounds in high years of inflation and an early retirement at 62 makes it very, very attractive as we saw in the late seventies.

I wonder if you discussed that at all?

Mr. **Conable**. Will the gentleman yield?

Mr. **Campbell**. Be happy to yield.

Mr. **Conable**. It was discussed at great length and frankly I supported it. It was knocked down largely on the basis that you are not dealing with the same people who retire early as you are with those who retire later.

There was strong objection from the labor union elements, since people who retire before 65 are largely blue collar and those who stay after 65 are usually, but not always, professional people.

That was the argument anyway. I must say that it was interesting to try to build some symmetry between the incentive to work longer and the disincentive to retire early.

Mr. **Campbell**. I appreciate the gentleman's answer. I don't want to go over my time, but I did want to say that obviously, as you raise payroll taxes and you have a cap on the total amount, that the proportion of total income paid will be higher by blue collar than white collar overall so when you raise the payroll tax you are penalizing the blue collar worker in his working years and it would seem you would look at an adjustment in the incentive for earlier retirement as an alternative to raising that tax, especially as that applies to out years of 2015, for example.

That is the debate I wonder whether you held?

I assume your answer is yes, you did, and couldn't reach consensus on it, is that correct?

Mr. **Ball**. Yes.

Mr. **Greenspan**. Yes.

Mr. **Campbell**. I have more questions but the hour is late and I will not pursue them because I know there are plenty of people who will ask the same thing. I yield back.

Chairman **Rostenkowski**. Mr. Russo?

Mr. **Russo**. Thank you very much, Mr. Chairman.

Members of the Commission, I want to compliment you, as my other colleagues have done.

You have spent considerable time discussing these issues and you have put together a very extensive product.

One of my concerns, as I watched, reported what the Commission did, I wonder if you felt there wasn't a climate created that frightened the public because of the way the media summarized what you accomplished, as opposed to the media's role which is, as I see it, to educate people about what in fact you had to overcome in arriving at these various conclusions?

I raise this with you because in dealing with my constituents, I hear a lot of comments that you are cutting my benefits, you are taxing me to death, you are eliminating the system, without any understanding of why these compromises were developed.

Mr. Greenspan, I was wondering if you felt that the media could do a better job in educating our citizens as opposed to frightening them by the way they depict a year's worth of work?

Mr. **Greenspan**. No, actually I think the media did an extraordinarily good job on this.

There is a problem that inadvertently showed up in this type of fairly complex set of negotiations and conclusions and it is that we tend to use shorthand. When you get into a lot of complex discussion in order to avoid spelling out long paragraphs, you tend to condense things. You use language that is not exact.

As a consequence, when, for example, we use the words "cut in benefits," what we mean exactly is a lowering of benefits that would exist under current law which usually means a decline in the rate of increase of some form.

Now, the problem is that if we use those terms as indeed everyone tends to, the media reports it exactly, but, there are people who would with some justification misinterpret it.

Is that the media's fault? I think not.

Can we change that? Probably not.

But I do certainly agree it has been most unfortunate that in the context of all of these discussions a general view that what the Commission was up to was to cut benefits when in fact there was nobody on the Commission who literally was in favor of taking current benefits and reducing them.

Mr. **Russo**. Yes.

Mr. **Ball**. I have perhaps a couple of comments that differ a little from the chairman on this.

I don't fault the media in any sense because this is an extraordinarily complicated and difficult subject to report. I am sure everybody has done it with the best of intentions, but one simplification that has continued to creep into this and is even reflected in some questioning by committee members, is that the Commission recommendations are aimed at the short term, and not the long term.

The Commission recommendations, in solving the short term, reduce the long term 1.8 by 1.22 and leave out there only a small part of the long term.

It isn't as if the recommendations were for the short term. They are both.

That sort of thing gets in and all you can do is keep trying to correct it. It is a simple way of describing it. I disagree with the chairman on the idea that, if you change present law so people get less benefits, it is not a cut in benefits, but a reduction in the increase.

Of course, it is only a reduction in what present law provides in purchasing power but the 6 months moving of the COLA, which I support under these circumstances, is a real cut.

There is no way to avoid it.

Mr. RUSSO. My concern has been that in trying to report in an abbreviated period of time complicated matters, that a climate of fear gets created. I sense it from talking to people in my district.

Mr. BECK. I think there has been a tremendous amount of fear out there for some time, but in my judgment the media has been so much more accurate over the last few months and done so much better a job of describing the social security situation that they have really aided the educational process.

It is something in which there will always be room for growth and improvement, but this has been good reporting time.

I would like to give them very high marks for their reporting during this time.

Mr. TROWBRIDGE. Congressman, I concur, thinking particularly of some of the magazines and printed media that have had the space and time to research it and spell it out. I think they have done an extraordinarily good job.

I don't think we should overlook the fact that throughout last year leading to the November elections there was a lot of rhetoric on the campaign trail that did not help the climate in which this Commission worked, not the solution that we were seeking.

That is, a balanced solution.

There were a lot of shorthand political statements that by their very nature scared people.

Mr. RUSSO. Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Hance.

Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman.

I would join the other members of this committee, in thanking the members of the Commission for the job they have done.

While each individual item in the package is difficult to support, the whole package is a good one and one I believe a majority of the Members of both the House and the Senate will be able to support ultimately.

Mr. Greenspan, you had mentioned in your remarks in response to Mr. Conable that if we don't come up with a solution to the problem, the international and domestic financial markets would be in a state of total disarray.

Would that apply if we solve only the short-term problem and leave the long-term problem unresolved or would these financial markets be satisfied if we deal only with the short-term problem?

Mr. GREENSPAN. If I inadvertently said total disarray, I would like to edit those remarks.

Mr. MATSUI. That was probably my characterization rather than yours.

Mr. GREENSPAN. I may have easily led you in that direction. I think they would react negatively and, considering the fragility of the international financial structure and the level of interest rates, that any adverse response is more than we could probably afford at this point.

I think that it would be negative if we merely addressed the short term and did nothing with respect to the long term. What the problem is, as far as the money markets is concerned, basically, is not what inflation is next month or 6 months or a year from now;

they are concerned that there is something fundamentally wrong with the American economic system which changed it from one largely resistant to inflation for a couple hundred years, to one now clearly prone to it.

If the financial community of people who invest money, who save money, who try to look for interest returns, come to that conclusion, then this country is going to be in very bad shape economically.

Consequently, anything which addresses the longer-term problem and resolves it, I think will be perceived positively and the failure to do that I think would be a bad mistake reflecting on those of us involved in this decisionmaking process.

Mr. MATSUI. You are then saying that if we have to solve the long term problem by increasing the taxes, you would prefer us to do it that way than to ignore the long-term problem because of the possible financial market consequences?

Mr. GREENSPAN. I wouldn't consider those the only two possibilities. In other words, for example, if you told me that the Congress would address the issue next year rather than this year, and the question were increasing taxes or leaving it open, I would have to think about that.

But, if you were asking me, do I support that we do one or the other and as quickly as possible, if that were the only choice, the answer is yes, I would support whatever the Congress does to close the 1.8-percent gap.

Mr. MATSUI. Your long-term solution consists of two factors: one is increasing the age of retirement to 66 and the other, indexing the age of retirement on the basis of longevity.

I talked with the staff of the Ways and Means Committee, and I was advised that all we had to do was increase the age of retirement from 65 to 66 and not deal with indexing to pick up 0.6 or six-tenths of a percent. Is that correct?

If so, why did you get into the indexing part?

Mr. GREENSPAN. I am frankly not sure.

As I recall—we do have indexing in there.

Mr. MATSUI. That is not correct, I don't believe.

Mr. GREENSPAN. I stand corrected.

Mr. Myers, who made the estimates for us, says that in fact there is implicit indexing.

Mr. MATSUI. Then the information I have was incorrect.

Mr. GREENSPAN. It does raise 0.65 percent taxable income over the long term.

Mr. TROWBRIDGE. One of the options we looked at was in the option book the staff prepared. It was to gradually increase the retirement age from 65 to 66 in 2014, beginning the phase-in with those who attain age 62 in 2005 and it would have been valued at 0.41 percent of long-term payroll.

In other words, just that 1 year was less than the amount that we were seeking but it was a sizable portion of it.

Mr. MATSUI. I see.

Mr. PICKLE. Would the gentleman yield?

Mr. GREENSPAN. Point 41, if you include 66 and stop there.

Mr. MATSUI. I see.

Mr. TROWBRIDGE. Yes.

Mr. PICKLE. Would the gentleman yield?

Mr. MATSUI. Yes.

Mr. PICKLE. I want to get the comments of the committee.

With respect to this long term you have recommended, you say we should raise this 0.58. Eight of you go with age, five by raising of taxes. Now, you said another possibility would be to slow the growth of benefits.

My question to you specifically with respect to raising the taxes in the later years, Would you support—does that mean when you raise the taxes in 2010 that that would include a refundable tax credit?

Does that mean at that point the credit would be part of this package?

Mr. BALL. That was the recommendation of the five appointed by Democrats.

Chairman ROSTENKOWSKI. The gentleman will suspend. You will have an opportunity to go into this after 2 o'clock.

Mr. Dorgan.

Mr. DORGAN. Thank you, Mr. Chairman.

I would like to ask Mr. Greenspan, How much discussion, and could you recount it for me, did you have on the question of significantly increasing the cap on which social security is computed?

Mr. GREENSPAN. The cap?

Mr. DORGAN. The cap on the wage base.

Mr. GREENSPAN. None that I recall. We implicitly accepted the existing law, indexing the escalation of the base with no change.

Mr. DORGAN. Current cap, as I understand it, would go to about $45,000 in 1986. Was there no discussion about the potential of increasing that significantly?

Mr. GREENSPAN. In the abstract there has been a lot of discussion, but no serious discussion about altering that, that I recall.

Mr. BALL. It might be useful to remind you, Mr. Dorgan, that Mr. Kirkland proposes that on the employer's side the cap be removed entirely and the tax apply to the entire employer's payroll. That is his proposal to substitute for the coverage of Federal employees.

We discussed, but as the chairman says, without taking it as a very serious possibility, we discussed raising it in general on both sides.

Mr. DORGAN. All right.

Mr. BECK. There were several on the Commission violently opposed.

Mr. BALL. You could have persuaded me, probably.

Mr. DORGAN. Underscore "violently"?

Mr. BECK. Yes. Yes.

Mr. DORGAN. Mr. Greenspan, this economy of ours is in essentially the same position as we were in the first quarter of 1979. We have had some growth and some recession that soaked the growth back out and we have had this spurt/sputter economy for about 4 years now.

As I understand it, your predictions about the future economic growth in the country are moderate, you feel.

What if we have a brief recovery this year, but continue this spurt/sputter type of approach we have had in the past several years? What happens to predictions or recommendations you have made in this package?

Mr. GREENSPAN. One of the more important recommendations that this Commission is making rests upon our understanding of the way the social insurance, social security system is constructed. There is no way which one can guarantee its basic solvency largely because the trust funds are constructed in a manner in which funds flow in and funds flow out but the flows are not constructed such that you are guaranteed to have a positive balance.

In other words, there is no way to do that. Therefore, we concluded that we had to introduce what we call, one, the stabilization recommendation which is instituted for 1988, whose essential purpose is to diminish fluctuations in the fund; and a fail-safe mechanism which essentially would trigger in the event that the funds reached levels in which monthly benefit payments failed to be adequately financed.

The reason we did that is that we recognized that there was no way to guarantee by a series of recommendations without adversion to what the economy was doing which said, with no question, the funds will be solvent.

Is it possible that in the event there is a decline in economic activity in 1984 or assume we go up a little here as we are turning and then dip down. If that happens, I would say we are in trouble.

As I said in my prepared remarks, it is possible that we could run into trouble in the years immediately ahead.

In the longer term period, I think we are fairly well solidified from 1988 forward.

But, it is possible under very adverse economic circumstances, which I must say I give a very low probability to. The economy could be weak, but social security difficulties would require something more than that.

It requires basically that productivity either stabilize or more exactly go down and, considering what has happened to the economy in the last 2 or 3 years, I think that is very unlikely.

The other side of the unemployment coin, if there be anything that can be perceived of as good, is the fact that the private sector has become very lean and, as the economy recovers, that means productivity will rise rather quickly. This is another way of saying that the level of wages on which social security taxes are exacted will be moving at a faster pace than the CPI. If that occurs, that pretty much means that the system will remain in balance.

Mr. DORGAN. Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Mrs. Kennelly.

Mrs. KENNELLY. Thank you, Mr. Chairman. Let me add my voice to say thank you to the Commission for a job well done.

Could I take this discussion a step further, Dr. Greenspan? I have in front of me a committee print of unemployment figures. Under pessimistic assumption, it predicts in 1982 a 9.8-percent unemployment rate; 1983, 9.6 percent unemployment.

Now, say we continue with the present double digit unemployment rate that we have and possibly even go higher, would that be enough to destroy the Commission proposal because we will still hit insolvency.

Mr. GREENSPAN. Not in and of itself unless productivity declines with it.

The actual productivity issue, meaning really the gap between the wage increases and price increases, is in this particular context a far more important issue than 1 percentage point in the unemployment rate. If you gave me a figure of 15 percent or something really extraordinarily adverse, then you do have trouble.

But I think the odds of that happening have got to be considered to be small. That is the reason why, rather than endeavor to capture all adverse possibilities which any of us can think of which meant you probably would appropriately fund not $168 million but $268 million, we thought it was far more sensible to introduce technical elements within the procedures of how the system functions, namely the stabilizer and a fail-safe mechanism.

That makes more sense than continuously endeavoring to guess what the economy is going to do.

Mrs. KENNELLY. Thank you. Other members have asked you if you thought the proposal would be dead if a substantive piece of it was dropped. You said, yes. What about the groups that come to us for relief and we decided instead of a $168 billion figure we would come in at $155 billion? Do you think that amount would hurt the proposal so that it could not go forward?

Mr. GREENSPAN. Depends on how you got it. In other words, if you revised data and made small changes in a lot of things, probably not. If it occurred as a consequence of taking one of the elements out of the system, I would say you would probably lose a number of Commission members' support.

May I just add, since the question has been raised several times about how we individually would react in the event that certain things specifically in the long range either went to increased retirement age or increased taxes; that, remember, is not involved in the Commission's report. This Commission effectively goes out of business technically completely liquidated on February 20 and we are all on our own.

I just want to emphasize that 12 of us have signed off on this total package including the 1.8 percent and the either/or possibility. I think what I don't want to say is we are all committed indefinitely to the future irrespective of what happens in this whole area and I don't think we should be.

In other words, I think that we shouldn't, any of us, be tied to what contingencies could arise. I do want to emphasize, however, that we have all agreed to the 1.8 percent, that it should be closed and it should be closed in one of two ways.

Mr. CONABLE. Will the gentlelady yield?

Mrs. KENNELLY. Certainly.

Mr. CONABLE. I do think it is awfully important to understand, though, that we start shifting around the elements in this package a lot and you are going to find a lot of commissioners that are going to be teed off and they are going to be coming in and saying that is not what we agreed to so don't expect us to support it.

But the package as drawn, I think you will find most of the commissioners right down to the wire will support us, for whatever good that is because we are individuals.

Mr. TROWBRIDGE. Shouldn't we add that what happened on January 15, Congressman, was that the Commission made a recommendation and at the same time it was agreed to and accepted as a package by the President and the Speaker and the majority leader of the Senate and other leaders of the Congress. It really is their perception of the package holding together which has more impact on the future of it than the Commission's, in my opinion.

Mr. CONABLE. Absolutely.

Mr. TROWBRIDGE. I think the deal was everybody laying their hands on the table at the same time and saying this is the best solution available, let's move with it.

What Commission members may say after this committee and the Congress has taken your next step is really less relevant than the leadership's perception of it.

Ms. KENNELLY. Mrs. Fuller, was there any serious discussion of the earnings sharing proposal in the Commission?

Ms. FULLER. We did discuss it but not in any depth. We discussed the fact that there are issues relating to women all the way through our deliberations. The package has minor technical improvements that affect some small groups of women.

In my way of thinking, that is not reform that goes to higher labor force participation and higher divorce rates. We are emphasizing though, under the circumstances, the emergency situation we have with respect to solvency both in the short term and over the long term, and I think that every—well, most commissioners I would say felt that the fact we didn't go into them in depth was not a signal that the Commission doesn't find them important, but, in fact, we did not go into them in depth.

In individual discussions, many of the Commission members personally said to me that they found the earnings-sharing idea logical and fair but there was no formal discussion of it and no formal vote on it.

Mr. BALL. Could I add to that, Mrs. Kennelly, and point out that in the supplementary statement of the five who were appointed by Democrats, there is support for earnings sharing as the most promising approach to the problem. All five of us agreed to that.

Mrs. KENNELLY. Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Ford.

Mr. FORD. Thank you very much, Mr. Chairman.

Mr. Chairman, I, too, would like to join with my colleagues in thanking members of the Commission for their important recommendations back to the Congress. I am going to be very brief because I know we have only a few minutes before we have to recess for the lunch hour.

Mr. Chairman, I would like to ask the Commission, of the recommendations that have been submitted to us; one of them calls for the 6-month delay in the COLA. Also, in future years the delay will take place from July to January. This is not only a one time delay in the COLA, it will continue in outyears as well; is that correct?

Mr. BALL. Yes, the increase moves to a calendar-year basis.

Mr. FORD. SSI recipients receive the COLA just like the social security recipients in the same amount.

Mr. Ball, I know that you have testified earlier but can you tell me whether or not it was the intent of the Commission to delay the

COLA for the SSI recipients, for those recipients of the social security benefits as well as the 2 million people who do not receive social security at all?

Mr. BALL. Mr. Ford, it was very clear that we did not address that issue. We took no position on it.

Mr. FORD. So the increase in the $20 to $50 disregard will not impact the delay in the SSI cost-of-living increase?

Mr. BALL. Let me make it clear: it was part of the consensus agreement that the disregard be raised to $50 for social security recipients, but we didn't take a position on whether the SSI COLA should be moved. We neither favor it nor oppose it. It was not considered a proper subject for this report. That is an open issue as far as this Commission is concerned. The administration has recommended it. I oppose it.

Mr. FORD. In the budget recommendations, the administration recommends also a delay in the SSI recipients' COLA. As chairperson of the subcommittee with jurisdiction over SSI, we will be hearing from members of the Commission next week, hopefully, and we will discuss it at that time but I wanted to know from the members of the Commission whether it was the intent of this Commission today to delay the SSI COLA, as well.

Mr. WAGGONNER. Let me reaffirm what Mr. Paul has said. The Commission did absolutely nothing with regard to delaying, making any recommendations with regard to delaying COLA's as far as SSI is concerned. The only thing that affects SSI is to increase the disregard for social security from $20 to $50 a month. Mr. Ball has properly stated it.

Mr. FORD. When we look at the disregards going to $50, we know that was not the intent to offset in any way the cost-of-living increase delay of SSI?

Mr. WAGGONNER. It in no way related to the SSI COLA.

Mr. FORD. Thank you very much, Mr. Chairman.

Chairman ROSTENKOWSKI. The Chair has made a commitment to members that have already left the Chamber that we will resume our sitting. However, I would like, because of the great interest in the matter before us, to take this opportunity to open it up for members of the Commission or for members that are here for about 10 or 11 minutes to make any other observations for the record or to ask my subcommittee chairman on social security and those interested members to just get into a dialog if there is anything that we have forgotten.

Mr. Pickle.

Mr. PICKLE. Thank you, Mr. Chairman.

By the way——

Chairman ROSTENKOWSKI. By the way, the committee has had the custom of coming back at 2, but not getting into a session until 2:15. So, when we recess, we will come back at 2:15.

Mr. PICKLE. Thank you, Mr. Chairman.

In order that I can have a better feel from your group, if we are short of funds on the fund in this decade, are you as a group willing to concede that one thing we could recommend would be to move up our wages and price difference from 1988 to 1984? Would anybody be opposed to that?

Mr. BALL. Yes.

I explained earlier, Mr. Pickle, that I think it is an essential part of the agreement that it go in in 1988. There are other provisions in the agreement that guard against difficulty should you have extraordinarily bad economic performance before 1988.

Mr. PICKLE. You are saying that we still would have to raise the funds but you wouldn't do it by moving up the stabilizer mechanism? You want to do it some other way?

Mr. BALL. I am saying the agreement itself provides for a way to do it. The agreement provides——

Mr. PICKLE. The agreement, Mr. Ball, also says that if we have a shortfall in the near years, that it could be corrected by a stabilizer or fail-safe. There is no specific recommendation of how to do that. I am just saying, What are our options?

Mr. BECK. It is quite possible that a kind of fail-safe could be made part of the legislation which would under certain circumstances, like the trust funds getting down to 10 percent, permit a fail-safe to go into effect similar to the stabilizer but moved up earlier to the point of time when the problem developed. That would not be inconsistent with anything that has been said in the agreement.

Mr. GREENSPAN. Let me be explicit of what the agreement was in this respect. Mr. Ball is certainly correct with respect to the question of what we agreed upon with respect to the stabilizer of the wages or prices and lesser under certain conditions.

What we agreed to was that, in the event the trust funds fall to a point where monthly benefits are in jeopardy, that something happens. Now, we couldn't agree on what that something was but that there should be something we all agreed upon. The two extreme positions on this was Mr. Ball, who wanted that something to be borrowing from general revenues, and I would have been on the other side in which I thought that what should occur would be a proportional reduction in benefits.

Both of us agreed that something should be done even though we disagreed on what it is. We also both agreed that 1988 was the year that the wages or prices, the lesser, should be instituted as part of the agreement.

Mr. PICKLE. I thank you.

I was just trying to get a better idea of your feeling because this committee has got to decide that thing that might have to be done if that eventuated.

Let me pursue one other thing. With respect to raising of taxes in the year 2010 you said a minute ago this would include a refundable credit.

Now, that means to me that that would be first I guess refundable only for the increment of the tax increase.

Mr. BALL. Only for the increment and only for the employee.

Mr. PICKLE. On the one hand we tax but then we give a tax credit, so the employee in effect does not pay any extra tax.

The employer is taxed but he writes it off as an expense. Now it seems to me if we raise the 0.5 or whatever that amount is, it would go to the fund but it would seem the Treasury was being hit. We lose funds from the Treasury at that point.

Do we have a sort of hybrid situation? Normally if you give a tax credit it follows that you are going to tax benefits when they are received. But if you give a refundable credit and there is no tax to it, then there is no funds being raised except it comes out of the Treasury.

Is my analysis incorrect? It seems to me sort of an uncomfortable feeling with respect to just raising the taxes to give a refundable credit. But I would like a comment from anybody on the panel.

Mr. GREENSPAN. I would say you are correct in your interpretation. That is one of the reasons I am uncomfortable with it and the reason I voted for the retirement age and not the credit.

Mr. WAGGONNER. Mr. Chairman.

Mr. PICKLE. Mr. Waggonner.

Mr. WAGGONNER. You have properly stated what the refundable tax credit is for as regards the employee for only the year 1984. It is intended to be couched in terms of being a temporary tax, refundable.

My concern stems from the fact that this is a major tax policy matter. Congress has over and over and over again refused refundable credits. So I am uncomfortable in that respect, as is Mr. Greenspan, because he has properly stated this for you, but that is only couched in the terms I gave and it would be incumbent on Congress to legislate a continuation of that tax refundable credit.

Ms. FULLER. I would like to amplify for a moment. The idea of the refundable tax credit being for only 1 year was absolutely critical to the support of certain Commission members. In no way was it mentioned as anything longer than 1 year—I know it was negotiated through the process, originally it was in there for longer—the 1-year limit was one of the things required to get certain of the Commission members to sign; I would be among them.

The idea there is any refundable credit linked with any other provision, short term or long term, was never part of it and it would have materially affected the outcome.

Mr. PICKLE. I am glad to know that.

Mr. BALL. I want to be sure everyone is clear on Mrs. Fuller's last statement.

No one is proposing any change in the agreed-upon part of the package. But what was left open for each group to decide how to address was the remainder of the long range, the 0.58, and though I greatly disagree with raising the age to 66 and then indexing, it is certainly within the agreement to propose that. It is certainly within the agreement for us to propose as we have a refundable tax credit in 2010. That is not a violation of any agreement whatever.

Chairman ROSTENKOWSKI. Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman.

I would like to know where the 1.8-percent shortfall we calculate over the next 75 years includes the 17.4 billion borrowed from the HI fund; and two, if we cannot—and we don't have control in this committee—deal with the 18 billion that is supposed to come from the Pentagon to put into the system, that would be about $35 billion altogether, does that have any consequences in terms of this 1.8-percent gap we are looking at over 75 years or is it such a small amount it's not relevant?

Mr. GREENSPAN. I would regret to convert the 1.8 percent in dollars which would be the denominator of the number you would apply that 18 billion or 20 billion or 30 billion. It doesn't affect the end result. Whether you include or exclude it.

Mr. BALL. You do have jurisdiction, I believe, Mr. Matsui, over the question of paying for the military service credits. The way we would propose to do it is you would just put it in the bill as an appropriation.

Mr. MATSUI. I see.

Mr. BALL. In S.1, which is the only legislative language that exists now—that bill in the Senate does it that way.

Mr. MATSUI. So we do have jurisdiction over that issue and we could——

Mr. BALL. Well, I assume so.

Mr. MATSUI. OK. that is all I have. Thank you.

Chairman ROSTENKOWSKI. Mrs. Kennelly.

Mrs. KENNELLY. I have no questions, Mr. Chairman, thank you.

Chairman ROSTENKOWSKI. Jake, anything else?

Mr. PICKLE. Mr. Chairman, I yield back the balance of my time.

Chairman ROSTENKOWSKI. The committee will resume its sitting at 2:15.

[Whereupon, at 1:14 p.m., the committee recessed, to reconvene at 2:15 p.m.]

AFTERNOON SESSION

Mr. PICKLE [presiding]. The Chair will ask the committee to come to order.

We will resume the discussion with the panel.

I see that Chairman Greenspan has stepped out, but he will be back.

I wish to thank you for your testimony this morning and your willingness to come back on short order, but it is important that we maintain the schedule and adhere to it as we have set it out.

The Chair will now recognize Mr. Hance.

Mr. HANCE. Thank you, Mr. Chairman.

I have several questions.

First of all, I have a question for Mr. Ball.

You served under three previous administrations, and I assume in 1977, when changes to the system were made, that you were consulted. How actively were you involved in making the changes in 1977?

Mr. BALL. I was not officially involved. I left the Government in 1973, but members of the Carter administration did consult with me.

Mr. HANCE. Did you think that the 1977 remedy was going to solve the problem until the year 2030, like the proposal suggested it would?

Mr. BALL. Yes, Mr. Hance, I did. I recognized, as the actuaries said at the time, that the early years were quite thin, but on the basis of the best estimates available, it looked as if it would do.

Now, you have to distinguish between the short and long term. It went wrong because of the short-term economic situation. There was no reason to change the view that, under present law, there is a very good period for social security between 1990 and 2020, or 2025.

Mr. HANCE. I had a constituent ask me: "Congressman, they said the system was going to be OK for 50 years; they missed the mark by 47 years." I said, well, I guess that is close to what happened.

Mr. BALL. The point is, what went wrong was entirely a short-term economic question and affects the program between now and 1990. The system under present law is still estimated to be in good shape out there to 2020, or 2025.

Mr. HANCE. Some of us have been more concerned than others and felt perhaps the system was in a little worse shape than generally believed. We have been working on our constituents for the last year, hoping that everybody will realize that somebody is going to have to give a little here and there.

I have had a lot of townhall meetings in my district, and one proposal had overwhelming support. I have been amused that you all have not recommended it: postponing the age of early and regular retirement.

You have talked today about postponing it to 66. But most of the people that I represent thought it would be very fair starting, say, 10 years from now, to postpone retirement 2 months a year for a total of 18 years and gradually move the early retirement age to 65 and the regular retirement age to 68.

Did you all ever consider that?

This would be to the Chairman: Why was that idea dismissed? Was it just not serious? Was everybody just afraid to face the music on that one?

Mr. GREENSPAN. It is caused by the nature of the agreement that we had. It starts off sequentially by agreeing first that the long-term deficit to be resolved was 1.8 percent of taxable payrolls.

Having then agreed on the short-term solutions which came out to 1.32 for the long term—after a 0.1 adjustment, we ended up with a gap to be resolved of approximately 0.6.

Going from 65 to 68 would create a much larger impact, and so that in the context of the agreement, we filled it in completely with retirement age.

It just turns out that the amount that had to be filled at that point under our specified preagreements goes from 65 to 66, starting just after the year 2000, whereas the proposal that you are suggesting, Mr. Hance, would have created far more impact than, in fact, we agreed to try to capture.

Mr. HANCE. If you did postpone retirement to 68 from 65, that would certainly move the system into a more financially stable position; wouldn't it?

Mr. GREENSPAN. It would be a very substantially larger impact on the deficit.

Mr. HANCE. I would think that if you did that, though, there would have to be an obligation to those that had worked in a lot of blue-collar type jobs, where physically it wears you down sooner. Could not their probems, be they disability or otherwise, be addressed separately?

Mr. GREENSPAN. I would address their problems separately, irrespective of the nature of the change in the retirement age.

Mr. HANCE. One other thing—let me ask you this on a show of hands—you have been put on the spot before, and this will be one more time.

How many of you would consider that one of the things that we should seriously consider for the long-term solution, is to look at the possibility of moving the retirement age to 65 and 68 over a long period of time, and then addressing the in-between problem with disability?

Mr. GREENSPAN. The reason I would like to interrupt, we have had a long discussion on that with great debate on all sides, but we have all signed off on, that is, so far as the majority, on the 65 to 66 in the context of 0.58.

If we were to come out for, say, going from 65 to 68 earlier, we would, in fact, be abrogating the agreement, as I would see it.

Mr. HANCE. OK. I won't put you on the spot, then. I don't want to mess up your prior agreement.

I will tell you this: The public does not want us back in here in 3 to 5 years having to go through this again.

The worst thing that we can do is not fix this, and I am really concerned whether we are actually fixing this or buying some more time. Every day that we just buy time, we hurt ourselves with the young people, and that is one of the things that we have to look at.

I appreciate the work you all have done on this whole issue.

One quick question. One thing that I have had a lot of complaints on has been the payroll tax going up for the self-employed. I guess you are trying to offset that by allowing the deduction of what they are paying in, which brings that out of general revenue?

Mr. GREENSPAN. It is trying to make it symmetrical with somebody who would be incorporated; in other words, in effect, an individual who, under current law, incorporates after being self-employed is handled differently, and what the recommendation attempts to do is to make the self-employed tax status similar to that of an individual who incorporated himself.

Mr. HANCE. Thank you very much.

Chairman ROSTENKOWSKI. Mr. Gradison will inquire.

Mr. GRADISON. I would like to inquire upon a subject touched upon earlier. It has to do with the relationship of the recommendations of the National Commission to the financing of medicare.

I believe I understand what the Commission has said. My concern is simply this: That unless the advances from the HI fund are repaid reasonably soon, we may see a financial crisis in the financing of health care for the elderly upon us quicker than if the advances are repaid in the next few years, and it is not clear to me whether the proposals which are being made contemplate an early repayment, by which I mean in the next 2 years or so, or whether that is being left aside fundamentally for the other group to explore.

With regard to Mr. Hance's point, for example, we are talking about the same constituency, and even if we patch up for the long term, 75 years, that part of this program which affects the retirement, if we are back in a relatively few years talking about how to arrange a trade-off between higher taxes and less benefits for the same constituency, in health care portion, we may be subject to the same criticism.

How fast, Mr. Chairman, do you, as a commission, expect that the advances could be repaid?

I will follow it up with a couple of very closely related questions, if I may.

Mr. GREENSPAN. That is difficult to answer, Mr. Gradison, largely because it is a function of two things: one, economic performance and therefore the status of the OASDI funds, and two, the drains on the medicare trust funds themselves, as a consequence of requirements on them.

I think it is an issue which clearly this committee should focus on, and in the sense that these are both drawing from the same revenue pot, as I said in my opening remarks.

It should not be an issue relative to OASDI. Well, it would not be if a fail-safe mechanism were put in place, but I think that it does raise the question more in terms of the hospital insurance funds than it does the OASDI, because I do think that while we have explicitly placed that outside the realm of our considerations, a number of us who looked at that, nonetheless, are concerned that that is an issue which we cannot sweep under the rug repeatedly.

Mr. GRADISON. I appreciate your comment.

It suggests to me, and I say this to my subcommittee chairman, we may have to take a look at that to see the relationship of these proposals to the repayment of those advances. For example, if we were to move up the effective date of the COLA trigger to an earlier date which was, I believe, one of the questions asked by Chairman Pickle earlier this morning, the repayment of these advances in time to, "save the HI fund," might trigger the change in the COLA to a wage rather than a price base a lot earlier than the compromise contemplates.

I am stating the obvious but it is important to get that possibility out on the table.

Mr. GREENSPAN. I understand, but remember, merely triggering a wage or price, the lower, doesn't necessarily make any difference and the most likely effect of that is nothing in that the purpose of the stabilizer is to endeavor to capture those rare events when the rate of increase in price is greater than the rate of increase in wages, and I certainly grant we have had an unusual set of years in which that has occurred, rather than extrapolate the most recent period as evidence that therefore it is the long term trend, it is just as reasonable to assume that there will be an offset, meaning that having gone through this as the British like to say, "employment shedding," it is quite likely that productivity will be taking on annual positive performance for the indefinite future which means that wages or prices, the lesser, will still always mean prices.

Mr. GRADISON. I would like to ask one final question, and it is this: If we are going to have unlimited interfund borrowing for the future, what is the purpose of continuing to have these as separate funds?

I assume we are going to have the actuaries studying the different components in any event, but if it is going to be unlimited borrowing, would it be simpler just to consolidate this whole thing, and eliminate the need for borrowing by having a single trust fund?

Mr. **Greenspan**. Well, clearly if you have unlimited interfund borrowing in both directions, then as a bookeeping matter it is of no relevance.

Mr. **Gradison**. Yours was borrowing from the HI fund by the old age fund.

Mr. **Greenspan**. The recommendation that the Commission really go through 1988 on this question, and basically, I guess, is operating under Joe Waggonner's premise initiated earlier today, "If it ain't broke, don't fix it." In other words, there is no need to do it, although clearly it is not a major issue one way or the other.

Mr. **Gradison**. Thank you.

Chairman **Rostenkowski**. Mr. Flippo will inquire.

Mr. **Flippo**. Mr. Chairman, if I might, Mr. Chairman, I would like to ask the gentlemen if any of them would care to respond to the question raised about the equity of the proposed increase in the tax on self-employment. Some have suggested that your recommendation is an extremely regressive tax on those who are not in the 50-percent tax bracket. Would you care to comment on that, any member?

Mr. **Ball**. If I could back up just a minute as to what the situation was when the self-employed were first brought in. It was decided, at that time, just as a compromise, to charge them one and a half times the employee rate. They get the same benefits as everybody else, and for everyone else the double rate is paid, so actually the present situation is unfair.

Everybody else in the country covered by social security is paying somewhat more for social security because the self-employed are paying somewhat less. If they were paying the double rate, obviously other people wouldn't have to pay as much, and this is an attempt to correct an inequity and to say that the proper rate for everyone to pay for the same benefit credits is a double rate.

Once you do that, of course, half of what the self-employed pay—just as it would be for the employee—is analogous to an employer contribution and it ought to be allowed as a business deduction.

This seems to me a correction of a problem and an inequity, not the introduction of an inequity. It recognizes what now seems to me unfair.

The result is about $19 billion in income between now and 1990 for social security, about $12 billion offset as a result of the business deduction by the self-employed.

Mr. **Waggonner**. Mr. Flippo, on the subject of the self-employed, you are going to have to make a determination whether or not in the instance of the tax refundable, refundability available for the employee for the year 1984, will the self-employed who is both an employer and the employee gets that refundable credit, too?

You understand what I am saying?

Mr. **Flippo**. I think so, Joe, but if you care to elaborate further.

Mr. **Waggonner**. The self-refundable tax credit is available in 1984 to the extent the tax is advanced 1 year from 1985 to 1984.

The employee gets a refundable credit for that advanced increase, but the self-employed are not just employers, but they are employees, too, and you will have to resolve that question about whether that self-employed who is both employer and the employee, pays both, does he get in the instance of that advanced portion of the tax for that 1 year?

Mr. FLIPPO. Thank you. Thank you, Mr. Chairman.

Yes?

Mr. BECK. My recollection is that a marginal tax rate for both the self-employed and for corporate bodies is remarkably similar in terms of equity, that that will still mean some poorer corporations and some poorer self-employed will be paying a higher tax rate, because they will get the value of a lesser deduction.

Mr. FLIPPO. I thank the Chair.

Chairman ROSTENKOWSKI. Mr. Anthony.

Mr. ANTHONY. I was absent for part of your testimony.

One of the suggestions that the Commission has made, without making a very specific recommendation, was the so-called notch or the cliff that would exist between the taxable and nontaxable breakoff point of $20,000. In private conversations, I have heard this brought up by several Members of Congress, and it seems to me it is disturbing them some. It is something we will have to address, because it is a very large savings. We probably will not be able to throw this particular provision out, or otherwise we will undo all of your credible work.

Were there some suggestions tossed around in your private meetings, and if so, could you elaborate on some of those, please?

Mr. BALL. The one that I favored, Mr. Anthony, would be above the thresholds of $20,000 and $25,000—This is not an agreement, just my personal preference—for each $2 of outside income, nonsocial security income, I should say, start to tax $1 of social security benefits up to the point you have reached one half of social security benefits.

That phases it in. It loses some money in the proposal. I don't have an estimate of exactly how much but it might be in the neighborhood of as much as $3 or $4 billion, I presume.

If you wanted to adjust the threshold slightly to account for that so you came out the same, that is a possibility.

Mr. ANTHONY. Would this be basically——

Mr. CONABLE. Would the gentleman yield.

It is very difficult to design elimination of the notch problem without also reducing the revenue that the social security system will get.

We have notch problems in almost every program that you can think of. We will have to use our ingenuity some because it is a problem to have virtually a cliff where somebody making $19,999 pays no tax and somebody making $20,001 pays a tax.

So we are going to have to work on it but the Commission did not want to get into the technical details of defining that and it is obvious that it is going to require some ingenuity not to give a great deal of revenue in the process of eliminating the notch.

Mr. ANTHONY. I agree, and, in fact, as we go through changing the social security system once again, we continue to create all sorts of different classes within the social security system, because every year the Congress changes it. People do draw different benefits based on different laws that have been enacted and it becomes difficult when you have to talk to one of these people that has fallen off that cliff and give him some rational explanation of why you did it.

Any suggestions that you can come up with so we can handle it from a rational basis up here, so maybe we can handle it from a political standpoint when we go back home?

I have also received some inquiries from people who say they have been discriminated against because of laws enacted years ago. They happened to be born at a particular period of time, and they don't get the benefits that some other people get.

If you have some suggestions as to how we might be able to work them into the solution at the same time, I may be interested in offering some amendments in that area.

Chairman **Rostenkowski**. Mr. Thomas.

Mr. **Conable**. Mr. Chairman, that is a real problem, but it is not the problem of the compromise.

That 17 to 22 notch problem was generated by the 1977 act and not by any compromises before us now.

Chairman **Rostenkowski** Mr. Thomas will inquire.

Mr. **Thomas**. I am much less concerned about the notch problem on the income tax than I am on the age, and I understand, Mr. Greenspan, a deal is a deal, and that you dealt with the adjustment in retirement age looking for *x* amount of money.

From my point of view, that is exactly the wrong way to go at it, but I understand the narrow problem that you were dealing with.

I would like some discussion about the behavioral changes between the sexes that we have to deal with, but also the problem between the young and the old and on the equivalency of work and retirement, which is the only equitable way of comparing between different eras, that there will be a lot of young people who are concerned about the fact that on an equivalency basis, since you don't kick the increased age factor in until the year 2003 or beyond, there was already built in a 7-year windfall benefit on the equivalency ratio for those folks.

Is there any merit to talking about examining the equivalency and phasing it in from an earlier period to a later period, so when you reach your indexing, you don't have the notch problem on the age?

You were looking for income. I am asking for advice for this body, as we have to take your recommendations and put them into law. Might we not be saving ourselves a political problem by dealing with attempting to remove that significant notch factor, and if you use 1980 as a base for 65, it is still a 2-year windfall.

Those folks falling on one side of the line get a 5-year equivalency benefit between working and retirement, and those on the other side don't.

I want some reaction, if you can. I would appreciate some comments from you, written or otherwise, about what went on in your meeting, so I can better understand how you came up with the pattern that you did.

Was it looking for that almost 0.6 percent of payroll, and that is how you came up with it, and is that a politically reasonable way to go about solving this notch problem on equivalency?

Mr. **Greenspan**. Am I supposed to answer the retirement question to 66?

Mr. THOMAS. I will take anybody's reaction in terms of a discussion of that equivalency problem. You wound up with an indexing procedure which seemed reasonable, based upon changing life expectancy.

You get to that point. The way you get there, as I understood your comments earlier, you needed *x* number of dollars, and so that is when you kicked it in, and you did not go to 68 because you did not need the money?

Mr. GREENSPAN. Correct.

Mr. THOMAS. We already have a significant age-notch problem built in if you don't begin building into——

Mr. GREENSPAN. Longevity rises faster than the adjustment problem. Is that what you mean?

Mr. THOMAS. Yes.

Mr. GREENSPAN. What is politically the appropriate way? I guess it is related to one's point of view.

We had two problems. One was that we grappled with what we decided had to be the size of the long-term problem, which had to be closed. Some of us thought there should ideally be some overkill, and there were others who thought it was unnecessary disruption of the system. It was a compromise which was struck on the aggregate size which was a very important agreement.

Would I have preferred 65 to 68 fairly quickly? Sure, I would, but there are a lot of things I would have preferred other than what the compromise was.

Indeed, there are a number of other notions which Bob Ball or Chairman Pepper, or others, would have liked. The importance of this compromise is the fact that, with the differences that exist amongst us, that we were able, in effect, in the name of resolving this problem, to sign off on a series of less-than-desirable conclusions on individual items which I think we now are all acutely aware is built into the nature of this problem that now confronts us.

Mr. THOMAS. I applaud the Commission on its bipartisan presentation, and I am not looking for symmetry for symmetry's sake. I am trying to resolve a very real problem between the payers and the recipients who get benefits, because the youngsters pay in, and they don't get the benefit of the equivalency at the high end that the people who are going to be receiving it get.

To me, it is a very real political problem.

Ms. FULLER. I would like to make a comment, not so much on the package, but if you were coming at the reform from the standpoint of reforming the retirement age such that there is some kind of equity, building in the fact that longevity would say that the retirement in 2015 would be 71, how do you divide up the increased lifespan between working and retirement? Also, how do you take into account the fact that there are certain segments of the population who may burn out before others, because of the kinds of work they are doing?

The most preferable way from my standpoint of approaching that problem as the problem, as distinguished from in the context of our agreement, would be to start a phase-in that would end up with age 68. You are kind of splitting the difference between 65 and 71 and getting some benefits in terms of increased number of retirement years, and also treating separately the disability problems for people who work in heavy labor, who are becoming less and less as a proportion of the total work force.

Coming out of the room, I looked at it as a question of how do you get there from here, and maybe we can't get all the way there the first time around because of what was portrayed to me as the political realities, what it takes to get something enacted in time to avoid an emergency.

I would hope there would be a way of taking a smaller step than I would find desirable in the context of this agreement in order to avert a more disastrous emergency later this year, but then continuing to work to get to the point where you do have a more equitable balance in my judgment between the working years and the retired years.

Mr. **Thomas**. My problem is, if we are going to advertise this as a fix, I want to make sure it is a fix. We can't afford to come back and do it in increments.

We are going to get one shot at it, and that is it.

Mr. **Ball**. By accident of who happens to be here among the Commission members, I am the only one who is opposed to raising the age at which full benefits are first payable. I understand you will have witnesses tomorrow from among those appointed by Democrats who will feel as I do, but the conversation keeps going on too congenially, and I thought maybe there would be the impression that the Commission, as a whole, was sort of going in the direction of raising the age.

That is not so. The five of us appointed by Democrats are strongly opposed to that whole approach.

Mr. **Thomas**. I am enjoying Mr. Ball's position as a beleaguered minority.

Chairman **Rostenkowski**. Mr. Pease.

Mr. **Pease**. I would like to commend the Commission for an excellent piece of work.

I would like to focus my questions on the provisions for bringing in new Federal employees into social security.

I am especially grateful that the Commission recommends that an independent supplemental retirement plan should be developed for those new employees, but I am concerned that there might be some slippage; in other words, if we put the new hires under social security before a supplemental plan is in place, there may never be a supplemental plan.

I think that would be unfair to the Federal employees, and unfair to the Nation from the point of view that adequate pension plans have always been a good argument for Federal employment.

Could any of you express an opinion on making the coverage of Federal employees under social security contingent upon the adoption of a supplemental retirement plan for those employees?

Mr. **Greenspan**. If I may address that question, when an average private employer sets out to hire somebody new, he usually has a number of fringe benefits and a variety of elements which make that particular employment desirable.

Sometimes, those things change or drop away afterward. As a private employer, we have fringe benefits right now which differ quite considerably from what we had 5 or 10 years ago. Some are better, and some are worse. Some people stay for a very long period of time, and some people leave.

It strikes me that we are trying to create a status for Federal employees which has a characteristic to it far superior to that of the average private employment. It does not strike me as particularly a major problem if somebody is thinking of Federal employment, and essentially is sort of not necessarily promised, but is given the expectation, that there will be a private pension plan, my own view, as I cannot, in my remotest hallucinations, believe that there won't be, but are we not endeavoring in this context trying to treat that class of individuals who become new hirees as special citizens?

My own view is that we should not. They are perfectly capable of choosing Federal employment or not. I think that those of us who have been Federal employees have considered that we are all treated fairly. Some have not with respect to the problem of the way the flattening of the wages in the upper income brackets have occurred, but I see no reason why the issue of the Congress deciding whether or not to put Federal employees in social security should be contingent on that.

Now, that is my own personal view and perhaps as a private employer, I have a different view from others who have not been.

Mr. PEASE. Mr. Greenspan, your hallucinations in that regard are more sanguine than mine are. I can easily concede, particularly under the present political circumstances, that Congress could take the step of putting new hires under social security, but either the Congress or the administration would balk at the second step of providing the supplemental retirement system for them.

Mr. GREENSPAN. I don't find it credible that the administration would, because it was implicit, if not explicit, in the President's agreement to this particular compromise solution.

Mr. PEASE. Yes?

Mr. TROWBRIDGE. One other fact that may not be responsive to your question, but again we keep asking ourselves, "Compared to what?" in this whole process.

When we first talked about extending coverage, we talked in terms of all of those who had not yet vested in the Federal service system, and it was with that in mind that we proceeded. Then it became fairly evident in discussions that the difficulty of converting those people with 4 or 5 years of service into some new plan, which would then be matched with social security, was really a very severe administrative, and possibly legal, problem.

Where we came out with new hires only was in fact a decision to say "Let's not create a bigger problem than we can manage in the time available." There was an assumption that the new hires coming aboard on January 1, 1984, and afterward would have a pension plan available from the Government as an employer, just as a private-sector employee would have.

Mr. BECK. Another factor that warrants some consideration as well is that the new Federal employees coming under social security will start off with survivorship benefits from the very start, disability benefits, and these were benefits that were not similarly made available to them under civil service.

The only benefit that won't be starting right away, unless there is an integrated plan put on immediately, is retirement, and that benefit is long deferred.

I would hope that we could separate out that pension at this point only to permit the legislation to move forward at the fastest possible speed, but still plan on putting together a supplementary pension program for people under new civil service employees to be introduced and put into law before the year ended.

Chairman ROSTENKOWSKI. The Chair would like to get an indication from the members in the second go-around. Could I see by a show of hands which members still have questions?

Mr. Pickle?

Mr. PICKLE. Mr. Chairman, several members had made inquiry of me if we could receive testimony from Dr. Bob Myers with respect to his recommendation on the Federal hires, the controversy that possibly exists, and it was my suggestion that we might hear from him this afternoon.

I notice that some of the members who want to hear that are not here this afternoon.

Could Mr. Myers be available tomorrow? You might comment on that and have the opportunity for others to hear you.

Now, I am going to repeat a little bit on stabilizing.

You recommend that the stabilizer take effect in 1988. Why do you recommend that it take effect only until that time? What is the reason that we could not move it up?

Why did you choose 1988, and why couldn't you move it up as a matter of policy?

Who wants to respond to that?

Mr. WAGGONNER. I want——

Mr. PICKLE. Why was it selected, and why didn't you want to move it?

Mr. BALL. The trust funds at the present time for OASDI are very low.

It will take time to build those funds up, and wages or prices, whichever is the lower, is triggered by the trust fund ratio—the amount in the fund in relation to the amount of outgo in the following year. We did not want the provision of wages or prices, whichever is the lower—which is a stabilizer—to come into effect until the trust funds had an opportunity to build up again.

If you put it into effect very soon or right away, it wouldn't be as a stabilizer, it would be putting into effect wages or prices, whichever is the lower, right away, because the trust funds would be below the 20-percent figure.

In 1988, in that year, that 1 year only, you would count the income during 1988 before the 20-percent trigger would operate.

Mr. PICKLE. Yes?

Ms. FULLER. I would like to make a comment, too.

In the context of our agreement, we agreed on wages and prices, the lesser, and we agreed on 1988 for reasons articulated by Mr. Ball.

The question that you may be asking, and Mr. Hance asked a similar one, what happens if we have a greater-than-anticipated shortfall and need to take action before 1988? Would this be helped by accelerating that stabilizer?

The problem with accelerating that stabilizer, it may be that we have a greater than anticipated shortfall, but wages and prices are moving in tandem, so it would not help you with the shortfall if you implemented it.

In order to help you with the shortfall related to the COLA before 1988, there are other things you would have to do, and one example would be to put an arbitrary cap on the COLA for a couple of years.

Another alternative would be to base it on wages minus 1½ percentage points; so automatically the revenue would be coming in based on growth, and wages and the outgo would be based on wages minus, so you would be building up the trust funds. These are two things that could be done if we get to that point.

They are outside of the agreement which was based on assumptions that we would not have to do that.

Mr. PICKLE. We still have a problem here with respect to the stabilizer.

You help the system because the proposal you made really protects high inflation, low wages. It does not work the other way around with respect to making any other savings, and that constitutes a problem for it.

If we don't move it up, all we have is a fail-safe, which you don't agree to just hanging out there.

Nobody can reach agreement to it. We may have to settle that.

Mr. BECK. Mr. Chairman, Mr. Pickle, that was the understanding; that the open items were possible increases in the retirement age or taxes, which might be Mr. Ball's approach, or the use of a fail-safe and several different alternatives suggested.

Some people believe that the fail-safe device should be one that implements the stabilizer earlier if it is necessary, but we look to Congress to resolve that question.

Mr. PICKLE. We are going to have to look for a fail-safe, because we don't have one now except in the very broad and general sense which you blew a kiss at the problem, and we have got to try to settle that.

One last question: If we were to start over again, do any of you think that you could come up with a better or more valid package?

Chairman ROSTENKOWSKI. Don't answer that question.

Mr. GREENSPAN. A better package; is that what you said?

Mr. CONABLE. There isn't anybody who couldn't come up with a better package by himself.

Mr. GREENSPAN. We could come up with 15 new better packages.

Mr. WAGGONNER. I thought Mr. Pickle and Mr. Conable had what they thought was a better plan last year.

Mr. PICKLE. We did have a good plan last year, but this is 1983.

Mr. BALL. To answer your question very seriously, in my judgment, it would not be possible. This is the best that we could do.

Mr. BECK. I agree with that.

Chairman ROSTENKOWSKI. Mr. Vander Jagt.

Mr. VANDER JAGT. Thank you, Mr. Chairman. In reference to Mr. Pickle's last question, it is interesting that the man to whom The Washington Post a few weeks ago gave credit for founding the system, or devising the system, said he could come up with a much better plan than the one he came up with, and he made some mistake in view of what has happened in longevity, and such things, so he would like to do it over again.

One question for the panel, and it really arises out of, Mr. Ball, this morning your addressing what I think is a great erroneous impression that is out there in the media and among the public to some extent. That is the impression the Commission came up with a short-range solution but has a long-range problem, and I understood you to say that, yes, the short-range problem is about 1988; this package addresses that, but that the whole panel pretty much agrees between 1890 and the year 2010, we don't have much of a problem.

Mr. GREENSPAN. I assume you mean 1990?

Mr. VANDER JAGT. 1990; thank you, Alan.

If that be correct, that between 1990 and the year 2010, we pretty much have a surplus of income over outgo, then a short-range solution seems to me a bit of a misnomer.

We have a solution that carries us to the year 2010, and I will be in my 80's and not many members of the Ways and Means Committee will be around, and I don't see Congress lying awake nights wrestling with thorny political problems that won't occur until the year 2010, so that was a very good clarification, but I want to know, do the members of the Commission agree that this package not only addresses the problems that we face between now and 1988 or 1989, but that the system also will be in pretty good shape until the year at least 2010.

Is there anyone that disagrees with that, assuming some accuracy with the other economic assumptions that have been made?

Mr. BECK. I think we will have a medicare problem before that time.

Laying that aside, I feel comfortable that the 1.8, while maybe not all that we need, it is not that far away from being a reasonable target to shoot at.

Mr. VANDER JAGT. The long-range problem is——

Mr. BECK. The whole point——

Mr. VANDER JAGT. The long-range problem comes in the year 2010.

Mr. BALL. After you have adopted these proposals, there is 1.22 out of the 1.8 that is solved.

Under the estimates that we are using, the remaining 0.58 is almost entirely in the last 25 years of the 75-year estimate.

It really goes considerably beyond 2010.

What we are focusing on here is, how to solve the 0.58; it is way out, not just to 2010, way out.

Mr. TROWBRIDGE. For fear that this might give us enough confidence to say we could live with only part of the package, I stress the need for that indefinable question of confidence. It is vital that the younger worker today really can believe that the program is going to be viable and solvent when the day comes for benefits to move his way. Second, if the way in which the longer term is addressed is in the extension of the retirement age, as much early warning of that new change in the rules of the game is, in all fairness, required.

Somebody looking at their own plans with a very, very short warning span is not going to be very happy over a last-minute change. We ought to give them the 20 or 30 years advance notice, if we can, by taking the action now.

Mr. **Waggonner**. The reason I express more pessimism than my friends on the Commission in the short range stems from the fact I know how the stability of social security is related to the economy in the overall, and vice versa.

I take the point of view that the performance of the economy is more related to the deficit problem in the overall with the Government than it is with what happens to social security.

If the economy does not perform, social security cannot be resolved, even in the short range, and I am simply saying I don't see a handle in the short range of Federal deficits.

This is the point I make.

There is no way in the short range for the economy to perform, unless Government gets a handle on deficits, and nobody is projecting a real handle on the deficits at the present time, and my point of view is, you absolutely cannot control the deficit situation in the long run, because of the compounding problem until something is done about entitlement programs.

I am not talking about cutting social security. I am simply talking about reducing the future growth rate of social security.

You can't solve social security if you can't solve Federal deficits.

Mr. **Vander Jagt**. Thank you.

Thank you all very much.

Chairman **Rostenkowski**. Mr. Pease.

Mr. **Pease**. Thank you, Mr. Chairman.

I would like to ask members of the Commission to comment on whether there was discussion within the Commission about the fact that so many people retire at age 62. There had been speculation that the Commission might make it less attractive to retire at 62 rather than 65. I do not find that among your recommendations. Is there a particular reason for that?

Mr. **Greenspan**. It is called "May 1981." I think most of us got the political message that the President got as a consequence. It is clear there was not going to be a viable choice. I don't know what other members' views on that are, but I think it was considered to be the type of recommendation which in effect had been evaluated politically in this country and found lacking.

Mr. **Conable**. Would the gentleman yield?

Mr. **Pease**. Be happy to.

Mr. **Conable**. There is, however, provision in 2003 that we will begin to accommodate just not the age 65, but the age 62. That is part of the recommendation of the majority of the Commission, it is not part of the recommendation of Mr. Ball's cadre.

Mr. **Pease**. I noticed in the summary of your recommendation that under current law the HI tax rate for self-employed persons is 50 percent of the combined employer-employee rate. You have suggested that in the case of retirement and survivors—disability benefits, rather, that the 75 percent be raised to 100 percent. You do not make a recommendation in the case of HI, do you?

Mr. **Greenspan**. No, I think we explicitly covered only OASDI in our recommendations.

The issue did surface, Mr. Pease. The reason we didn't address it is that once we started to address the question of the impact on HI it probably would have carried us into making similar recommendations in a number of other areas that were associated, and I think it was a general awareness that the narrower we kept our agreements the more likely that we would in fact reach them.

So I think that that was left basically unaddressed.

Mr. **Pease**. In your Commission report, do you address the financial health in the long run of the HI trust funds? Your recommendations, do they deal with old age and disability or do they also deal with health insurance?

Mr. **Greenspan**. No; in fact, very early on we decided, Mr. Pease, that because of the technical problems involved that, to delimit the scope of what we were doing, we consciously decided to deal solely with the OASDI with the obvious exceptions where there were certain other matters. In retrospect I am pleased we made that decision, because the size and nature of the problems that exist in HI are of the same dimension, in fact larger than the OASDI system.

If we just barely made it on the retirement and disability, one could pretty much have forecast where we would have ended up there in grappling with the total.

Mr. **Pease**. If I could slip in one question before my time expires.

Was there discussion in the Commission about what used to be called the three-legged stool concept, whereby social security was supposed to be one part of the family's security in retirement years? A lot of people have forgotten that in the last decade and have looked to social security as supposedly adequate for their total retirement needs.

Would some efforts at public education be appropriate in this case?

Mr. **Ball**. Actually, Mr. Pease, I think that the concept of social security being part of what I call a four-tiered system has grown. When social security started there was very, very little in the way of private pensions.

Actually, because it started at the Depression, there was very little in the way of savings either.

Recently, private pensions have grown to cover about half the active work force—the private work force, that is—and with provisions like the individual retirement accounts, and with Keogh accounts, the reality of supplementation of social security is much greater than it has ever been.

I don't think for above-average earners social security can by any stretch of the imagination be considered sufficient in itself. So, you have this underlying compulsory contributory social insurance system; private pensions for about half of the earners—mostly those with above-average earnings—individual savings—particularly homeownership among retired people—is the third part; then finally underlying the whole, the means-tested system of supplemental security income.

So, our approach in this country to retirement income is now clearly multifaceted. The various parts are noncompetitive, in my view. These are complementary approaches which work well together.

I would like to see them all remain intact. There is no way to completely get rid of a means-tested program for example, without great distortion of the others.

So I think our overall approach works well.

Mr. PEASE. Thank you.

Mr. BECK. Mr. Pease, if I may, I feel compelled to respond, though having a somewhat different view than my associate.

We did talk about the three-legged stool and I wouldn't totally argue with that fourth leg that Mr. Ball has referred to, but there are many of us who feel that the private pension system and personal savings can take a larger share of the total burden, and incidentally there are some 70 percent of the people working now who have been working for at least a year under age 25 who are under a private pension system.

So, with IRA's and Keogh's and private pensions as a complementary or supplementary system to social security, there is every reason to believe that this four-legged stool can be much more viable in the future than it has been in the past.

Mr. PEASE. Thank you very much.

Chairman ROSTENKOWSKI. Mr. Dorgan.

Mr. DORGAN. Mr. Waggonner talked about his concern for Federal deficits and the prospect of economic recovery in light of those deficits. I don't want to minimize deficits because I think the budget proposed yesterday indicates a fiscal program that is seriously out of balance, and we need to take action to deal with that.

But I would like to say the deficits, while important, are completely overwhelmed by the misguided monetary policy down at the Fed and the economic fortunes of this country in the next 12, 24, 36 months are far more related to the disposition of Mr. Volcker than to nearly any other factor.

That is important to keep in mind. That is why I asked the question about economic assumptions. I would like to ask the question that follows up on this morning's question I had about the base of the tax.

I asked about whether the wage cap, removal of the wage cap had been considered by the group and the discussion was that there had not been a lot of consideration, that there was in fact some violent opposition to it. But the question of how much tax you raise is a function of the rate versus the base, the higher the rate, the more tax, the broader the base the more tax.

For the sake of discussion, why shouldn't the marginal dollar earned by the person who earns $100,000 a year bear the same responsibility toward retirement in this country as the first dollar of someone who earns $10,000 a year? Philosophically, is that a serious problem for members of the Commission?

Mr. WAGGONNER. Well, Mr. Dorgan, social security has an entitlement provision which is somewhat different from the taxing provision of a graduated income tax which IRS supervises. I don't think the Commission ever considered removing seriously the ceiling beyond those quantum steps provided for in the 1977 law, one of which became effective January 1 this year, and there is another one.

There was some conversation, but I don't have any memory of ever having seriously just removed the ceiling, but I think the difference between a ceiling in the entitlement program is somewhat different than an income tax which is graduated without a ceiling.

Mr. **Dorgan**. I understand. But, in the process of defining who pays the tax and how much they pay, it is determined by Congress what the base for that tax shall be. What would the revenues——

Mr. **Conable**. Would the gentleman yield?

Mr. **Dorgan**. Be happy to.

Mr. **Conable**. One problem that immediately occurs is that we have financed adjustments in the benefits by raising the wage base, thus if you start covering the entire wage base you will have to develop another mechanism for financing adjustments in benefits.

Another is that the benefits are based on a formula which rests on the wage base so as you increase the wage base, you increase the dynamics in the system in the long term by increasing the maximum potential benefit size.

That is one of the reasons why we have had some restraint about doing that quite apart from the issue of parity that exists between employer and employee.

Mr. **Dorgan**. I appreciate that.

Can you tell me what the revenue impacts would be, for example, in increasing the cap from $43,000 which it will be in 1986, to $85,000 or $90,000? Say you doubled the base for the tax. Has anybody estimated the revenue impact of that?

Mr. **Greenspan**. The trick is to figure out—it is not a guessable number. It is a published number. It is a question of what is the taxable income in those brackets.

It is not a small number. The problem basically is, as Mr. Conable points out, that its impact on the trust funds is not very large and if it is large it is basically saying that we are really pressing the system to essentially become a means-tested, largely welfare-related program, because the only argument that one could make about increasing the base is that benefits would rise accordingly. So, if you do that, you are not going to significantly improve the financial status of the system.

It is clearly not those people who are in need of increased benefits. If you don't do it, then you change the nature of the system.

So I would say either way you are probably moving in directions which would undercut the nature of what the OASI system is or has been since its inception.

Mr. **Ball**. The factual answer to your question, I checked with Mr. Meyers, is that the system over the 75 years would gain roughly a half percent of payroll, 0.5 or 0.6.

Mr. **Dorgan**. If you would indulge me for one comment——

Mr. **Ball**. This is if you move it up to 85,000.

Mr. **Dorgan**. I understand the point that Dr. Greenspan made and the point Congressman Conable made and I understand the need to preserve the coinsurance nature of the system. I am simply suggesting that we might need to consider a change in the wage base to insure the integrity and stability of the system.

Mr. **Ball**. Just in case my response, that I intended to be entirely factual, sounded like support for the idea, I want to clarify it. I do not support raising the wage base.

Mr. **Greenspan**. I don't think any of us do.

Mr. **Dorgan**. Pardon me?

Mr. **Greenspan**. I don't think any of us do.

Mr. DORGAN. I understand, but it doesn't mean it is not a good idea.

Mr. GREENSPAN. Not necessarily.

Mr. DORGAN. Thank you.

Chairman ROSTENKOWSKI. Mr. Campbell will inquire.

Mr. CAMPBELL. That line of questioning prompted a question. What percentage of people now pay more in social security taxes than they are in Federal income taxes?

I think the answer is here and I think he is coming up to the front with it.

Mr. MEYERS. The answer to that question, if you just consider the employee taxes, it is about 25 percent of the people. If you consider the combined employer-employee tax, it is close to half.

Mr. CAMPBELL. What will the projected figure be of people when you escalate the payroll tax and trigger in your self-employed?

Mr. MEYERS. I don't know.

Mr. CAMPBELL. No work has been done to estimate that?

Mr. MEYERS. No.

Mr. CAMPBELL. It will be a higher percentage?

Mr. MEYERS. Yes, it will be a higher percentage.

Mr. CAMPBELL. So we have 25 or 26 percent of the people now paying more in social security than Federal income tax and we were going up substantially from that.

Mr. MEYERS. It will go up, but I don't know how much.

Mr. CONABLE. Marginally.

Mr. GREENSPAN. The number of self-employed is not a large number.

Mr. CAMPBELL. But I was coupling it all, but we are going up to a point——

Mr. CONABLE. By 1 year.

Mr. CAMPBELL. But the question is prompted by this, and I want to pursue—go ahead.

Mr. BALL. I just want to remind you that under our proposal at least employees do not pay any more in social security contributions than they do under present law until 1988. It is the first time there is an effective increase for the employee under these proposals.

Mr. CAMPBELL. I understand, but that is not quite true when it comes to Federal taxes because in fact they are going to pay more under social security because you have a trigger offset to let them go against the Treasury as a credit on that advance tax, so in fact that will raise the amount they will pay under social security vis-a-vis Federal income tax.

Mr. BALL. If you figure it that way, yes.

Mr. CAMPBELL. OK.

Earlier in the day I asked the question and it came up again about the early retirement. Did you discuss how much impact indexing social security to the CPI had on people taking early retirement in your Commission? Did you have that discussion at all?

When they indexed it, what impact does that have on the number of people taking early retirement at 62, 63?

Mr. GREENSPAN. In 1972 indexing?

Mr. CAMPBELL. Yes. It might be interesting to note we had about a 9.5-percent jump when we started indexing in the number of people going for early retirement according to figures.

That tells me there is something out of balance in rewarding people for early retirement, with that much of a jump, and it also tells me that if in fact you had 10 percent fewer people taking early retirement, just 10 percent, that you are talking about savings in the range of about $5 billion over a period of about 4 years.

Mr. GREENSPAN. That jump occurs when, Mr. Campbell?

Mr. CAMPBELL. The jump occurs in the mid-1970's, well, I will give you the years. You start 1972, 64.5 percent of the people took early retirement.

By 1975 that had gone up to 73.2 percent. That is when you went into triggering.

Mr. GREENSPAN. Is it a 20-percent increase in between those two numbers?

Mr. CAMPBELL. About 9.5—excuse me, yes, it is a 20-percent increase in between the numbers.

Mr. GREENSPAN. When you begin to look at tradeoffs between working and retiring, a 20-percent increase in benefits can move a number of people at the margin which had nothing to do with the COLA situation.

Mr. CAMPBELL. Unfortunately, that has not been the history since 1962. It had only moved very, very marginally and fluctuated up and down until we went to that so there had to be a reason. That is the only thing I find that changed appreciably there. That is the reason I asked if you looked at it.

Mr. CONABLE. If the gentleman will yield, it coincided with the increase in rate of inflation which made it much more attractive to retire earlier.

As a matter of fact, our social security offices have been advising people to retire at 62 because they would be money ahead since that time, given high inflation.

That will correct itself to some extent as the CPI goes down inevitably. It is no longer as attractive to retire at 62 as it was back when you got a substantial jump in the COLA adjustment.

Mr. PEASE. Will the gentleman yield?

Mr. CAMPBELL. I don't have any more time.

I wanted one more question. If you would give me the time though, I will be glad to yield.

Chairman ROSTENKOWSKI. Go ahead.

Mr. PEASE. If the gentleman will yield, wasn't there a large lump-sum percentage increase in social security benefits in 1972 which would have made it more attractive to retire at 62?

Mr. CAMPBELL. The jump didn't come in. I was comparing as against 1975.

May I ask one more question?

Chairman ROSTENKOWSKI. Yes.

Mr. CAMPBELL. This is a totally different subject and I wanted to pursue the one I was on and the time got me but, as to taxing benefits of those earning $20,000 and $25,000 a year, did you discuss—leaving that as a static number instead of indexing like you did the rest of the system—what effect that has on the real earnings of people?

Mr. **Greenspan**. We considered it, Mr. Campbell, and rejected it.

Mr **Campbell**. Would you mind giving me your reasons?

Mr. **Greenspan**. Basically because it was again partly a revenue question.

In other words——

Mr. **Campbell**. It wasn't an equity question; it was strictly revenue?

Mr. **Greenspan**. Not really, because there is an interesting issue that gets down to the question of the nature of taxing benefits and do you do it in a lump sum or do you do it on a phased-in basis?

I think that not indexing is a compromise, in effect, sort of phasing down the real threshold point.

But it was an issue we did discuss and it was our consensus that it would be desirable, more desirable not to than to index.

Part of it was a financial reason; the funds raised do differ.

Mr. **Campbell**. It would be reasonable to look at the impact on the real earning of people over time, wouldn't it, from an equity point?

Mr. **Greenspan**. Of course, one should look at equity situations, but one of the difficulties I have in looking at it is that it is such a peculiar nature that there is a great deal of perceived inequity and one of the reasons why most of us don't like a number of the individual characteristics of this.

It is only because of the size of the problem and that it has to be solved for the good of the total system and the good of the country that we have to make these very tough tradeoffs.

Ms. **Fuller**. I would like to make one specific point on the indexing from an equity point of view.

There is a disadvantage from an equity point of view of indexing and that is that in the short term these thresholds are such that the people who will feel the tax are those who have saved themselves for their retirement and you are taxing savings. To index it would make that a permanent situation.

There is an equity concern in the situation where those above average in earnings get a lower return on social security taxes than those at the lower end of the spectrum. That exists now and that is part of the deal, but to add to that on a permanent basis presses the balance of equity.

Chairman **Rostenkowski**. Are there further questions?

If not, I once again would thank the Commission for all the work you have done. You have certainly made our job, by your report, much easier. I am sure that when we get to the markup, your telephones will be ringing, with us asking for some advice or for other reasons for particular positions.

I really appreciate all the efforts that you have put in, and please convey that to those members who were not able to be present and have these exchanges that we certainly appreciate the time and effort they have put in.

The meeting stands adjourned. Thank you very much.

Mr. **Greenspan**. Thank you very much, Mr. Chairman.

[Whereupon, at 3:40 p.m., the committee was adjourned, to reconvene at 9 a.m., Wednesday, February 2, 1983.]

RECOMMENDATIONS OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

WEDNESDAY, FEBRUARY 2, 1983

House of Representatives,
Committee on Ways and Means,
Washington, D.C.

The committee met at 9:05 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Dan Rostenkowski (chairman of the committee) presiding.

Chairman **Rostenkowski.** The committee will come to order. This is the second day of our hearings on social security reform. I am very pleased to welcome some of our most distinguished members. Certainly it is always a pleasure for the chairman of any committee to welcome the majority leader of his party and certainly in this instance it is with a great deal of pleasure that I ask our majority leader, Jim Wright, to please take the witness stand.

Mr. Majority Leader, we are looking forward to your testimony and I am sure that you will help enlighten us in the ideas that you so generously share.

We are looking forward to your testimony. If you will begin, the committee is ready to receive it.

STATEMENT OF HON. JIM WRIGHT, MAJORITY LEADER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. **Wright.** Thank you very much, Mr. Chairman.

It is, of course, a very great privilege to come before this committee on any occasion, and especially on this occasion today. On my own behalf and in the name of the House Democratic leadership I come this morning to congratulate the bipartisan Commission and to express our support for the basic program of reforms that it has crafted.

It is my personal view that the set of recommendations advocated by the Commission provides a fundamental framework by which we can honestly address the fears which have invaded the minds of many Americans over the future of the social security system.

This Congress could perform no greater national service than to guarantee that this most valuable instrument of public policy shall continue to serve and bless the coming generations in perpetuity.

Since its inception 50 years ago, the social security program has done more than any other single act of policy to promote the physical and mental well-being of the American people, to allay their fears of an insecure old age, give a life of dignity and self-respect to people in their years of retirement and in so doing to sustain the health and vitality of the entire national economy.

As reassuring as it will be to the American people to know that their Congress has faced the hard facts and made the difficult choices to guarantee the future of this program, they will gain additional respect for the basic underpinnings of our society from the fact that this set of reforms has been recommended by such an overwhelming bipartisan majority of the Commission.

The report contains a redeeming symmetry. Its burden is broadly shared. Employers, employees, self-employed, public servants, both military and civilian, and the retired themselves, each and all assume some sacrifice for the protection of this program. But upon none of them is the sacrifice unbearable.

The one-time sacrifice of one cost-of-living adjustment is a small price to pay for the continuation of this necessary indemnification against inflation. Some of us would prefer to see no taxes whatever placed upon any social security benefits. Surely $20,000 for an individual or $25,000 for a couple does not constitute what today most people would call a high income bracket but under the Commission's recommendation these basic figures refer to other income exclusive of social security and even then taxes would apply only to that half of the social security benefits which result from contributions paid by the employer.

These conditions, it seems to me, make that provision less onerous, if still not palatable then at least acceptable in the interest of preserving the entire program. Surely it is equitable that the amount of the disregard of social security benefits for purposes of determining supplementary security income payment levels would be increased from $20 a month to $50 a month. That will provide a measure of much-needed assistance to those at the lowest levels of income most needy of help.

For years it has been said by critics of the program that if social security were so valuable then employees of the Federal Government and indeed Members of Congress themselves should pay into the program. While it is undeniably true that a substantially higher percentage of their earnings have been paid by public employees into their own retirement programs than they would have paid in taxes if they had been covered by social security, there is an elemental equity in the contention of the critics.

If those of us in Government recommend it then those of us in Government should participate.

Let me urge, therefore, that we in Congress should on our own initiative agree to enlarge upon the recommendations of the Social Security Commission to require that Members of Congress, and not just new Members of Congress after January 1984, but all of us, pay social security upon our own incomes to the full extent that any other citizen of the United States is required to pay.

Let it be a talisman of our own good faith of our commitment to the proposition that this program shall be kept perpetually solvent for all future time.

In the past there has been legitimate concern on the part of some public employees that any move to bring future employees under social security would jeopardize their own hard-won rights under the programs in which they have participated—slightly differing programs for civil service employees, for military personnel, for Foreign Service people, for the Coast Guard and for several other individual categories.

While programs involving these different groups come under the legislative jurisdictions of at least five other committees of the House, I do think we should express here and now an absolute commitment that what we propose is not a merger of their systems with social security, nor a diminution by so much as one penny of the benefits for which they have paid and for which they are entitled.

Let us assure future employees brought under social security that it will not be a substitute which denies to them the privileges of participating also in the payment of premiums and earning of benefits in their own retirement programs.

Just as private companies have their own supplemental retirement systems independent of social security, just so under the Commission's proposal may those who are employees of any unit of government—Federal, State, or local. It is not our intention here to deny or diminish those rights.

There have been a few highly atypical but highly publicized abuses, aberrational from the norm, which have cast shadows of doubt upon the integrity of our systems. There can be, in my judgment, no rational justification for allowing any person to receive a retirement annuity greater than the salary currently paid to that person's working successor.

Let's say a retired colonel receives an annuity greater than the amount the colonel on active duty receives, or a retired Congressman receiving more in retirement than an active Member of Congress receives or any other category.

And if that inequity has not already been corrected—I was told by our colleague Bill Ford that he thought it had been in last year's law—then I recommend that the committees of proper jurisdiction take steps immediately to make it unlawful in the future.

This committee may desire to make additional improvements of one kind or another but I do believe that the Commission's recommendations form a fundamental and essential framework upon which we may build a lasting solution.

While the social security program must be considered wholly on its own, and not as a tradeoff with any other piece of legislation, we cannot avoid considering its example within the context of the Federal budget itself.

Of that, I simply want to make the following observation: It is manifestly inconsistent and unfair to demand in the name of deficit control that small businessmen, farmers, the self-employed and the workers, the students, the poor, the military personnel and the retired must sacrifice in the name of deficit control, while insisting that absolutely no sacrifice may be exacted from Americans in the higher income brackets who are the principal beneficiaries of the 1981 tax cut, which in turn is a principal cause of the deficit. Such a course would be iniquitous.

If we are serious about deficit control, I suggest that we shall have to consider the repeal or postponement of that third layer of tax cuts or at the very least a cap at some $700 on the amount that any one taxpayer may receive.

To fail to take any such action would be to abandon the most elemental principle of fairness.

That is a matter for another day. I trust that this committee will address that responsibility in ample time for the adjustment to be made well in advance of next July.

But for now, I express the hope that this committee and its members may report legislation to carry out the recommendations of the Social Security Commission in order that the House may act, decisively and without undue delay, before the end of March.

Chairman ROSTENKOWSKI. Thank you, Mr. Wright.

Mr. Wright, I know that your remarks suggested inclusion of Members of Congress. I have our staff doing a study presently as to how many Members of Congress are paying into the social security system because of outside income.

You are aware, of course, that the inclusion of Members of Congress would also mean that they would not be considered self-employed. Under self-employed status, people pay 9 percent, so that there would be a reduction in tax for Members of Congress in terms of how much they would contribute to social security. They would, under the new system, pay 7 percent.

I am also aware that it would be very unpopular for us not to be included.

As a matter of fact, if I were going to make a guess as to this committee, and I have not talked to all the members, the suggestion would be that the recommendations of the Commission be amended to also include Members of Congress.

But you know we often find ourselves in a catch-22. When we think the majority of us want to do what is right there is often an impression in the media that we are trying to do something devious.

I don't think that that is the intention of this committee.

I want to say at the outset that I know we will get the cooperation of the majority leader and the leadership on the critical issue. We recognize, certainly after yesterday, that this is a very fragile package. We also recognize that if certain elements of this package are not included or excluded that the possibility of its failure becomes quite evident.

I certainly have hopes and I have every reason to believe that we will get the cooperation of the leadership should we try to contain the package in as much its present form as possible, at least in the short run.

What we are concerned with, naturally, is the long term, and I think we as Members are obligated and commissioned to formulate the policy in the long run.

I would like to come up not with simply options but I hope some formulas to solve the long-term deficit. Is there any preference that you have, Mr. Majority Leader, with respect to what this committee could formulate to solve the deficit problems in the long term in social security? Naturally you have available as options raising the age, or changing the benefit formula.

Mr. WRIGHT. Mr. Chairman, I don't believe that the Commission itself was able to take a stand on that and I don't want to enlarge today upon those recommendations to the Commission.

For me to make, independently of their judgment, any recommendations for further long-term adjustments in the program, I think might be premature and might be somewhat presumptuous.

As for the other matter to which you made reference, I embrace and fully share the desire of the chairman to maintain as much intact as possible the basic framework of the Commission's recommendation. I think that is wise. I think it is prudent.

My suggestion with reference to Members of Congress themselves, I think is more symbolic than anything else.

The chairman is a far better authority on taxation than I would ever hope to be. Surely most, if not all, Members of Congress either have in the past paid into the social security system under employment that they previously enjoyed before coming to this place or presently on additional outside income which some of them may earn as a result of other investments or other activities.

But we hear it said repeatedly, erroneously, perhaps, through the media and otherwise, that Members of Congress don't pay any social security taxes.

Now, manifestly that isn't altogether true because last year's tax increase bill, the so-called tax reform bill, imposed upon Members of Congress a payment of some $670, I think, annually, into the medicare fund, which is part of the social security program.

But it does seem to me that in order to show good faith and in order for us to demonstrate our commitment to the proposition that since we are bringing all public employees into the system in the way that we are, that we ourselves ought, as a gesture, simply to say very well, any Member of Congress must be covered by social security to the full extent that any other citizen is. And up to the amount of income on which those taxes are levied.

If there are those of us who do not have additional outside income upon which we are paying social security taxes to that extent, then we ought to be expected to do so.

Now, I don't know about the self-employed status. The gentleman from Illinois, the chairman of this committee, introduced a question with which I just have no familiarity at all.

Chairman ROSTENKOWSKI. Mr. Conable?

Mr. CONABLE. Thank you, Mr. Chairman.

Mr. Wright, welcome before the committee. We are thankful to have you here.

Mr. WRIGHT. Thank you very much.

Mr. CONABLE. I am not sure that you understood the thrust of the chairman's question relative to the coverage of current Congressmen. Most of the members of this committee, every member of the Senate and most of the House leadership who accept honoraria for speeches outside their district would have a tax reduction were they to be considered employees rather than self-employed.

They now pay 150 percent of the employee's contribution into the social security system and would, under the proposals of the bipartisan Commission's recommendations, pay 200 percent. Were they to become employees they would pay only 100 percent of the employee's contribution and, therefore, the taxes they pay would actually go down.

Now, what I am concerned about is the old injunction, what webs we mortals weave when first we practice to deceive.

We are badly burned, Mr. Majority Leader, on the issue of the $3,000 ceiling on deductibility of expenses paid in Washington. We were seeking to put ourselves in the same category as everybody else and yet the President perceived that as a special deal for Congressmen.

Now, were we to cover current Congressmen by social security and thus have them pay only an employee's contribution to social security, we would actually be reducing the taxes paid by those Congressmen who receive substantial outside earned income as a result of honoraria, and that includes not only the $18,000 maximum that was collected by people who did such speaking generally but they are charged under the IRS with contructive receipt of those contributions to charity which are diverted to charity under the ethics rule.

Thus, people we would assume would be paying self-employment income on only the maximum of $18,000, if that was the amount they received, in fact have to pay social security taxes on a much larger amount by virtue of the intricacies of the interaction of the IRS and the ethics rules.

The result is, in fact, for all the Members of the Senate and for many Members of the House, a net reduction in taxes were we to be covered.

Now, I don't want to have it appear that we are in some kind of a conspiracy to appear to be virtuous and, in fact, to be reducing our taxes.

Chairman ROSTENKOWSKI. Will the gentleman yield?

Mr. CONABLE. Yes; I yield.

Chairman ROSTENKOWSKI. The chairman would like to point out that I have staff doing a study now as to just how many Members of the House of Representatives qualify for the reduction. I think that we will find out that after our study that there are no more than 50 or 60 that have the benefit of the outside earnings at either 18 or above the $18,000 mark.

But this is something that I am sure the majority leader wasn't aware of. We weren't aware of it until recently. So, until such time as that study is concluded——

Mr. CONABLE. Mr. Chairman, all I am suggesting is that this should be very carefully studied because we don't want to appear to be doing one thing and wind up appearing to be taking some special advantage for ourselves under the banner of virtue.

Mr. WRIGHT. Well, of course you don't want to do that and I don't think there is any question. The gentleman's suggestion is to introduce a new element of the matter to my mind. I was not mindful of that fact. I know, of course, that some of us do have some outside earnings from speaking fees and writing fees and pay social security taxes on that as self-employed individuals.

I don't know to how many Members that applies in any great detail. I have the impression that the average Member of Congress probably does not receive very much outside income for speaking fees and things of that kind.

Certainly it wouldn't be my intention to reduce the tax burden upon a Member of Congress, but rather simply to commit the kind of act that would reassure people throughout the United States who have fallen prey to somewhat specious reasoning. Nevertheless, if people in the government think that highly of the social security system, if they believe in it that strongly, then why don't they participate in it?

That may be a simplistic kind of a view but it is out there and you hear it in meetings. I dare say all of you have, as I have, attended town hall meetings of one kind and another throughout your districts and this sometimes comes up. People say, well, if you folks believe in social security all that strongly, why don't you participate in it? Why aren't you folks covered? Why don't you pay into it? And I was simply trying to reassure people to say yes, all right, fine.

Chairman ROSTENKOWSKI. I agree with you.

Mr. Pickle?

Mr. PICKLE. Well, I thank you, Mr. Chairman. It's good to see you here Mr. Majority Leader. The question of coverage for Federal employees, particularly Congressional Members, is simply to say we are mindful of it and we are trying to work out something that is acceptable. I hope this committee does not chase that congressional jackrabbit too long because we have other matters we should get to.

First I want to say you support the package?

Mr. WRIGHT. I do, yes, sir.

Mr. PICKLE. You are not trying to split it into details and overall we must support the general package and keep it intact. We must move it as quickly as possible.

Second, I notice you did not respond with respect to any kind of recommendation for long-term. That's a part of the package, and we have not decided how to do it. I would hope when we get together we could have the support of the leadership and advance a reasonable way to settle the long-term deficit that must be handled.

The other point I want to make to you is that, as I understand your testimony, you are saying that there is a certain amount of equity and fairness with respect to the third year tax. That if you are going to make taxation for other people and calling for sacrifices, you ought to consider that also. But I'm assuming the gentleman is not recommending that be done in connection with his legislation at all.

I want to be sure that you are not recommending we do that now?

Mr. WRIGHT. Not as part of this legislation but I would hope that the committee would act upon it because I suspect that that will be a part of the budget recommendation submitted by the budget committee and I expect it to be approved by the House either to defer or substantially to alter that third year tax cut because it is adding enormously to the defecit.

And while that is a matter of elemental equity which has to be considered in any balanced program, no, I'm not suggesting that you try to address that in connection with this social security legislation. I think it would be a mistake to do it. Perhaps some other vehicle may be available to which it may be attached in order that it can be considered in the House and in the Senate well in advance of July. I think we owe it to the taxpayer to put more notice and let them know what's coming.

But I notice, as I say to my friend from Texas, that yesterday's Washington Post reported an extensive Washington Post-ABC News poll in which the question was asked: "As you know, a 10 percent federal income tax cut is scheduled to go into effect this summer. Do you think that tax cut should be cancelled to help reduce the federal budget deficit?"

Republicans said yes by 56 to 37 percent. Democrats said yes by 56 to 38 percent. And so I would say I am offering you a bipartisan suggestion.

Mr. PICKLE. I appreciate your comments and observations. We are all glad that you got that on the record but that, too, is another one of those rabbits you can't chase in this bill. I am encouraged by the gentleman's support. I won't make light of it. I will sleep better knowing I have got your effective operation and support down in the House.

Chairman ROSTENKOWSKI. It is amazing how these Texans sleep better at night. We got Jack Valenti and now we've got Jack Pickle.

Mr. WRIGHT. Clear consciences, Mr. Chairman.

Chairman ROSTENKOWSKI. Any other questions?

Mr. Rangel?

Mr. RANGEL. Thank you, Mr. Chairman.

Thank you, Mr. Majority Leader, for your contribution to these deliberations. I am concerned with how we explain to the Federal civil servants what kind of package Congress will give them. Naturally, as you pointed out, they are pretty satisfied with the pension benefits they are receiving. I think what we are saying is that we don't contend that the ultimate benefits be decreased but rather that there be a supplemental alternative Federal civil service pension to supplement their contribution to the civil service and social security systems.

Does the leadership see the other committees working with this Congress toward putting that package together? What would be the timetable so that a Federal employee would know exactly what he or she should expect from Congress?

Mr. WRIGHT. Well, I just have to say that I don't see that it can or necessarily should be done hastily. I think we have to give to the Federal employees an assurance that we are not taking an action that is going to diminish this coverage or their protection when they retire.

The difficulty, of course, is as the gentleman from New York knows, this committee has jurisdiction over certain things. Then, civilian employees—the civil service people—are under the jurisdiction of the Post Office and Civil Service Committee. Military retirees are under the jurisdiction of the Armed Services Committee. Foreign Service personnel come under the Committee on Foreign Affairs. Railroad retirees have legislation that is handled by the Committee on Commerce. The Merchant Marine and Fisheries Committee has jurisdiction over retirement for the Coast Guard employees and there may be other categories. One category in which there is only one employee, the Comptroller General I think, is in a category all his own; separate and distinct from others.

So, in order for there to be some consistent policy, I think these various committees probably are going to have to sit down together and work out some guarantee.

All I am saying is that I think we ought to be able to say to the public servants of this Nation that what we intend is not something that is going to merge their program with social security and thereby diminish their program. Not something that's going to dilute what currently employed civil servants enjoy, nor something which is going to deny the future employees of Government the right to participate in their own retirement programs, in addition to the coverage that they get under social security.

Surely it would be unfair to do that because the municipal employees, and the State employees in most instances have their own retirement plans. Private employees working for any company of any substantial size usually have a coretirement program in which they participate in addition to social security. Therefore it would be unfair, I should think, to exclude civil servants from separate retirement programs when bringing them into social security.

Mr. RANGEL. I appreciate it, Mr. Leader, and it certainly is going to help this committee when the bill is finally reported and it would be even more helpful if a time frame was set up by the leadership so that those who would be affected would have even more assurances that it is a priority with committees other than Ways and Means.

Thank you.

Chairman ROSTENKOWSKI. The Chairman would like to inform the gentleman from New York that I have directed staff to write letters to the various committees making the observation that should this legislation be passed in the House that they should gear up for some program which would serve the purposes outlined by the gentleman from New York.

Mr. Schulze?

Mr. SCHULZE. Thank you, Mr. Chairman, and Mr. Majority Leader. It is a pleasure to have you before our committee.

I am sure you gave a fair amount of thought to the inclusion of Members of Congress before making your statement. I wonder if you considered also including those employees who deal directly with social security. One of the complaints that you stated came from your workshops, one of the big complaints I have received at workshops, is that those who send out the checks or are involved with that are unemotionally involved because they are not participants and I wondered if you considered including them?

Mr. WRIGHT. Are they employees of the Federal Government?

Mr. SCHULZE. Yes.

Mr. WRIGHT. Are they civil service people?

Mr. SCHULZE. Yes.

Mr. WRIGHT. I presume they would be included.

Mr. SCHULZE. Only new hires.

Mr. WRIGHT. In the same sense that other Federal employees are included, yes.

Mr. SCHULZE. I wonder if you would consider including all of them now in the same category as Congress. We oversee this and we are involved with it but those employees directly involved with mailing the checks also are involved. In the senior citizen communities, there has been expressed to me a great deal of concern that these Federal employees do not have the same kind of concern because they are not covered.

I know that that is not true, but I wonder if you considered including them.

Mr. **Wright**. I just have to say to the gentleman that I'm sorry, I did not know about it. I had not had the opportunity to consider it. What the gentleman says makes a certain amount of sense.

Mr. **Schulze**. I thank you, Mr. Chairman.

Chairman **Rostenkowski**. Mr. Guarini?

Mr. **Guarini**. Thank you for your testimony, Mr. Majority Leader. Jim, I think the remarks you made are very appropriate about Members of Congress leading the way and showing the rest of the nation that they are willing to make a sacrifice. I join with you in an endeavor and I also agree with you that we should look at the overall economy.

Last year I introduced this $700 tax cap bill. I am very happy to hear you make those remarks about the bill because I think this should be an important position for us all to take. I hope that you share and join with me in that effort.

Japan, I understand it was just announced, has 2.4-percent unemployment, the highest they have ever had since the fifties. We have almost 11 percent unemployment. And you can see the impact of every 1 percent on the collectibles that would be coming into the social security fund if we had 4-percent unemployment which I think was in the Humphrey-Hawkins Act.

In fact, as I understand, every one percentage point is around $2 billion in social security revenues foregone and over 4 percent unemployment you are talking about $14 billion a year shortfall because we are running high unemployment. So it is really our overall economy that's helping to throw social security out of whack. And I think we should address ourselves to the full picture and I thank you for the remarks you have made.

Mr. **Wright**. I don't think there is any question. The gentleman recognizes and faces very squarely the principal problems of all our institutions. The social security trust fund is one of the principal victims of the recession. I had heard a rule of thumb which may not be accurate but one that had been quoted to me by some of the people on the Budget Committee: equating each percentage point of unemployment to something more near $5 million lost to the social security trust fund.

If that be true, then we could hypothecate. The situation that if we were able to reduce unemployment only to the level of 2 years ago today, 7.3 percent——

Mr. **Guarini**. Our problem would not be as large.

Mr. **Wright**. It would be $18 million less because we have added some 3½ percentage points of unemployment in the past 2 years. And were we able to get back down to a much more acceptable level, let's say 6 percent, 5 percent, then manifestly we could make great contributions simply through the improvement in the economy to the health and solvency of the social security trust funds. Absolutely.

Mr. **Guarini**. We should address ourselves to the full economic picture and not just a part of it because there is that problem.

Mr. **Wright**. That is priority No. 1. We have to get people back on the productive payrolls and off the unemployment rolls to solve these problems.

Mr. **Guarini**. Than you, sir.

Chairman **Rostenkowski**. Are there any further questions?

Mr. Campbell?

Mr. **Campbell**. Thank you, Mr. Chairman. Mr. Majority Leader, it is good to have you here.

I am very impressed with the bipartisan approach to this. As I told the Commission yesterday, I thought they did an outstanding job. None of us would have written it that way had we had the individual right to do it but I, for one, on this side am trying very hard to support whatever we come out with and I am sure I will be able to after the committee works its will.

Mr. Majority Leader, I was a little disturbed, though, when I picked up the paper this morning and read that a fundraising letter had gone out, once again utilizing social security as a scare tactic to the elderly of the country. The letter, telegram or mailgram, excuse me, was essentially taking a hard, partisan line with Mr. Armstrong.

Yesterday, we heard about those opposing the plan. It seems that the partisanship may be in the opposition minority as well as the majority.

My question is: Don't you—and I would hope that you would and I am sure that you do—think that we ought to be putting this kind of partisan message behind us in trying to solve a problem? At this stage of the game this does not help and I would hope that you would address that.

Mr. **Wright**. Well, I agree with the gentleman that it would be well if we could restrain ourselves from criticism and campaign rhetoric. I have in my pocket one piece of such literature that is currently being distributed in my State which has a picture of the Speaker and a picture of me. And that picture of the Speaker I think is probably a very flattering picture. I don't find much wrong with that.

But the picture of me is so deficient. It lacks the capturing of the true character that my physiognomy should express. It makes me look drunk. One eye looks off here and one eye looks off there. And the campaign piece says, "Tip O'Neill and Jim Wright want you to stay at home Saturday, February 12th."

Well, now, I am not sure that anybody asked Tip or me—either one—whether we wanted those folks to stay at home on that particular day. I don't think that is a fair characterization of our position any more than that picture is a fair characterization of how truly handsome I am.

And therefore I certainly share the gentleman's chagrin over campaign claims that both sides make on occasion.

Mr. **Campbell**. Unfortunately, I share that and I am concerned about it and we have groups on the left, the right and all over that are not within either party.

I think, though, that the major parties involved with Representatives in Congress at this time should show an extra degree of restraint because the responsibility rests on their shoulders, and while we might utilize any other outside group in making the point, I should hope that our major parties would show that restraint.

Mr. **Wright**. I appreciate the gentleman's point of view and I think it makes good sense. It is time for us to join ranks and support this package.

Mr. **Jacobs**. Mr. Chairman, I just would state for the record that as a member of this committee, my party has sent solicitation and money to save the social security system and to my knowledge, none of that money has been put into the trust fund yet. Let the record show that.

Mr. **Campbell**. Well, let the record also show if we are going to show in the record——

Mr. **Jacobs**. Did the gentleman want me to yield?

Mr. **Campbell**. Thank you very much. I appreciate the courtesy and I am sorry that I infringed on the formality, but the fact is that I was not trying to push the issue hard with the majority leader. I was asking specifically for restraint from both sides and if we are going to put those in the record, I have three including two by the Democratic chairman and one by Mr. Pepper that say the same thing and I understand that money has not gone to the trust funds either.

Mr. **Jacobs**. Well, does the gentleman object to the letter that Phil Crane sent out asking for 50 or 250 or 30 or 10 or other dollars to be sent to save the social security system?

Mr. **Campbell**. No, but I have the one from the other side.

Mr. **Jacobs**. You say you do not object to that?

Chairman **Rostenkowski**. The time of the gentleman has expired.

Thank you very much, Mr. Majority Leader.

Mr. **Wright**. Thank you, Mr. Chairman. Thanks to all members.

Chairman **Rostenkowski**. The Chair has the great privilege of recognizing one of the more outstanding Members of our legislative body, a gentleman who has served this country in both the Senate and the House with great esteem. Senator Pepper, would you please take our witness stand?

Welcome to the committee, Mr. Chairman. It is certainly a pleasure to have you with us this morning. We know what a great contribution you have made both working in the Commission and in your service in the House and Senate.

Mr. Chairman, I am just hoping that when we have concluded our deliberations here that the same warmth will be extended to us when we appear before your committee and ask for a rule which I hope will ultimately mean the passage of this great legislation.

Is there a statement available?

STATEMENT OF HON. CLAUDE PEPPER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA, AND A MEMBER OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Mr. **Pepper**. Mr. Chairman, I would like to submit a written statement for the record and I would like to summarize my testimony, if I might, orally.

Chairman **Rostenkowski**. Without objection.

[The prepared statement follows:]

STATEMENT OF HON. CLAUDE PEPPER, CHAIRMAN, COMMITTEE ON RULES

No single function of government affects as many Americans as profoundly as the retirement, survivor, disability and health insurance protection provided by the nation's social insurance system: social security. Over 94 percent of America's aged receive a monthly retirement check, and 24½ million disabled workers and their spouses and children receive disability insurance benefits every month. Altogether, more than 36 million beneficiaries receive a check every month and 116 million workers contribute through the payroll tax to social security.

Between its inception in 1939 and the present date, social security has transformed the economic well-being of virtually every man, woman and child in America. The dramatic reduction in the incidence of poverty the aged, for example, can be attributed almost completely to social security. If not for social security, 15 million elderly Americans would live below the poverty line—about four times the present number. Social security is the primary source of income to 60 percent of all persons aged 65 and over, and is virtually the sole source of income for 28 percent of the elderly.

Although most Americans think of it as an old-age pension, social security is far more important, broad-based and comprehensive than any pension program. All 116 million contributing workers are building vital protection for themselves and their families. Social security is important to current workers not only because of the retirement, life and disability insurance protection it provides—social security relieves them from the financial burden of caring for aging parents, giving independence and dignity to each generation.

Currently, 139 million people of all ages are insured in the event of death or disability, and 95 out of 100 children have inflation-proof survivor protection. In short, Mr. Chairman, social security is a program for the ages, and for all ages.

Recent concern over the financing of the nation's social insurance system has placed social security at the center of a national debate, the outcome of which will be felt by everyone in America. The National Commission on Social Security Reform, on which I had the honor to serve as an appointee of the Speaker of the House, was a product of this national debate. Before proceeding with a discussion of the provisions of the Commission report, I would like to address the question of the system's financing.

(The Commission chose to limit the scope of its recommendations to the cash benefit programs—the Old Age, Survivors' and Disability Insurance system. In general, the factors affecting the financing of the cash benefit programs such as real wage growth and employment are distinct from those which affect the financing of the Hospital Insurance program such as health care costs and utilization. Accordingly, the quadrennial Advisory Council on Social Security will limit the scope of its 1983 report to the HI program.)

OASDI FINANCING IN PERSPECTIVE

The short range (1983–91)

One of the most important by-products, and certainly the most tragic, of the recent financing debate has been a considerable erosion in the confidence of the American people in their social security system. Millions of young workers believe that, when their turn comes to collect from the system that they have paid into for decades, no funding will exist for the payment of benefits. In short, they believe that the U.S. government will have sold them out.

For too long, public officials, elected and otherwise, serving in responsible positions have abused the public trust by shamelessly engaging in scare tactics. The shrill references to "impending collapse" and "going broke" have needlessly frightened millions of Americans with loved ones dependent upon social security. These dire, doom-and-gloom predictions had more basis in ideological hope than in fiscal reality.

The truth is that reports of imminent bankruptcy were greatly exaggerated. Social security funding problems are basically of a cash-flow nature, with incoming contributions falling barely short of the amount needed to cover all benefit obligations.

Social security cash benefits are financed from current payroll tax contributions. The contribution rate is set to coincide with the OASDI cost rate so that current contributions will roughly equal current benefit obligations. Any surplus of revenues over outlays is held in the OASI and DI trust funds, to be held for future years in the event that outlays exceed revenues.

The OASDI trust funds are simply a contingency reserve. It is no catastrophe for the trust funds to be drawn on—that is precisely the purpose for which they were created. If an extended duration of deficits occurs, the drawing down of the trust fund assets allows an uninterrupted flow of full benefit payments. This buffer provided by the trust funds gives the Congress the time necessary to adjust the contribution rate or to consider other financing measures.

As a contingency reserve, the trust funds do not contribute significantly to the system's financing. They are comprised of assets built up during years in which benefit obligations did not entirely consume incoming revenues, and they serve to fill in the gap when incoming revenues do not entirely cover benefit obligations. In short, the Commission was considering and we are here discussing the financing of OASDI at the margin—most of the future benefits promised by the system are already funded under current law.

Specifically, between now and 1991, the OASDI trust funds will collect $2.230 trillion in payroll tax contributions and disburse about $2.267 in benefit payments under current law. This amounts to a discrepancy of about 2 percent; that is, contributions will fall short of benefit obligations by about 2 percent of the latter. While this amount may be large in terms of dollars—social security is, after all, a large program—a 2 percent shortfall is hardly of sufficient magnitude to justify the chicken-little cries of an impending collapse.

Nor is the shortfall the result of some basic flaw in the benefit formula or some other fundamental defect in they system. Rather, the funding shortfall is attributable to the poor performance of the economy during the past decade.

By their very nature as part of a contributory social insurance system, the OASDI programs are sensitive to the performance of the economy. Because system revenues are based on wage growth and the proportion of contributing workers, and outlays are keyed to price growth, fluctuations in the rate of employment and the growth rates of wages and prices have a dramatic impact on the stability of the program.

For example, the social security actuaries estimate that each percentage point of unemployment costs the OASDI programs $3.5 billion in lost revenue annually. At full or near-full employment (4 percent unemployment), the OASDI programs would be solvent for at least the next half-century. Unfortunately, the present record levels of unemployment are robbing the system of its revenue base, and are even increasing its benefit obligations to the extent that older discouraged job-seekers are forced into claiming early retirement benefits.

Real wage growth, the other crucial determinant of the system's fiscal health, plummeted to unprecedented levels during the 1970's. Historically, the real wage differential exceeded 2 percentage points prior to 1970; that is, wages in covered employment grew faster than prices as measured by the CPI by 2 percent annually. During 1970–82, however, recurrent cycles of inflation and recession produced 7 years of negative wage growth. At the very time that low wage growth cut into the OASDI revenue base, high levels of inflation substantially increased benefit obligations.

The extended duration of poor economic performance shrank the OASDI trust fund reserves from $35.3 billion at the end of 1972 to $17.3 billion at the end of 1982. Not surprisingly, the performance of the economy will be the most influential factor affecting the system's financing in the next few years.

Table I illustrates the enormous impact of the economy on the cash benefit programs. Under the more pessimistic of the two mid-range sets of assumptions (alternative II-B) the excess of outgo over income during 1983–1991 is $37 billion, or 2 percent of expenditures. Approximately $65 billion in additional revenues would be required to maintain adequate reserves for uninterrupted payment of benefits under this economic scenario. It should be noted that a cost-of-living adjustment of 7.9 percent is projected for 1983 under this assumption, while the actual COLA is now expected to be about 4 percent.

Looking at the other of the two intermediate sets of assumptions, alternative II-A, substantial surpluses begin to accumulate in 1985, with a total net increase in trust fund reserves of $168 billion during 1983–91. By the end of 1991, the OASDI trust funds would have reserves exceeding $185 billion, or about 59 percent of the next year's outgo.

TABLE 1.—ESTIMATED OPERATIONS OF THE OASDI TRUST FUNDS ON THE BASIS OF THE 1982 TRUSTEES' REPORT ASSUMPTIONS, CALENDAR YEARS 1983–91 [1]

[Dollar amounts in billions]

	Alternative			
	I	II–A	II–B	III
Income	$2,348.0	$2,287.4	$2,230.0	$2,248.2
Outgo	2,042.2	2,119.3	2,267.2	2,545.1
Net increase in funds	305.8	168.1	−37.2	−296.9
Additional funding required [2]			65.4	312.5
1983 trust fund balance [3] (percent)	10	10	11	11
1991 trust fund balance (percent)	82	40	−12	−59

[1] OASDI programs as modified by the Tax Equity and Fiscal Responsibility Act of 1982.

[2] Amount of additional revenues or outlay savings required for uninterrupted payment of benefits.

[3] Assets at beginning of year as a percentage of outgo during year.

Source: Tables 5a–5d, Appendix K. Report of the National Commission on Social Security Reform, January 1983.

The so-called "optimistic" and "pessimistic" assumptions (alternatives I and III, respectively) illustrate the impact of economic extremes on the OASDI programs. Under the pessimistic scenario, annual average deficits of $33 billion would result. Conversely, surpluses averaging $34 billion annually would occur if the optimistic assumptions prove correct. I would add that the 1982 pessimistic assumptions have been revised in order to account for current experience of higher unemployment and lower inflation, which results in a somewhat smaller deficit.

The long range (75 years)

Although much is said and written about the projected status of the trust funds 75 years from now, the truth is that very little is known. Assumptions made with respect to inflation, wage growth, GNP, employment, longevity, immigration, interest and birth rates are just that—assumptions. I would submit that there will be other factors which affect OASDI financing, ones we cannot even contemplate at present, that will emerge in the future. In short, I believe that we should approach the long-term financing of OASDI with due humility and respect for the limitations of our ability to predict a future three-quarters of a century away.

As projections are made further into the future, accuracy and reliability markedly diminish. Most nations with social insurance systems make 25- or 50-year cost projections, but almost never beyond the latter. Only the U.S. and Canada make 75-year actuarial projections. With this in mind, it is important to note that virtually all of the problems associated with long-term OASDI financing occur during the last 25 years of the 75-year valuation period.

This does not mean that the social security actuaries' long-term projections are useless. Rather, the 75-year projections are guideposts which help to reveal general trends in OASDI financing under a given set of demographic and economic assumptions. What these projections reveal is generally dependent upon the eye of the beholder.

To the extent that the long-term estimates are used to set policy 75 years away, I would urge that the more pessimistic of the two intermediate sets of assumptions (alternative II-B) be used as a guidepost. The alternative II-B assumptions are generally regarded as the "best guess" estimate, as they contain conservative assumptions regarding economic growth and demographic changes. For this reason and for reasons having to do with the uncertainty of the future, the National Commission unanimously agreed to use the alternative II-B assumptions when considering the long range costs of OASDI.

The most striking aspect of the long-range financing picture is that under current law the OASDI programs are in close actuarial balance over the next 50 years. Demographic trends very favorable to OASDI financing which allow the buildup of large trust fund surpluses during the 1990's and the first decade of the 21st century account for this little-known fact. Table 2 illustrates the actuarial balance for the cash-benefit programs over the next 50 years, both as a percentage of taxable payroll and as a percent of program expenditures (OASDI is considered in close actuarial balance in the long run if estimated contributions are within 5 percent of estimated outlays).

TABLE 2.—COMPARISON OF ESTIMATED OASDI AVERAGE TAX RATE WITH ESTIMATED AVERAGE OSADI COST RATE BY ALTERNATIVE, CALENDAR YEARS 1982–2031

[As percent of taxable payroll]

	1982–2006	2007–2031	50-yr average
Average tax rate	12.01	12.40	12.20
Alternative I:			
Average cost rate	9.75	11.30	10.52
Surplus or deficit (as percent of program expenditures)	+2.26	+1.10	+1.68 (16.0)
Alternative II–A:			
Average cost rate	10.46	13.15	11.80
Surplus or deficit (as percent of program expenditures)	+1.55	−.75	+.40 (3.4)
Alternative II–B:			
Average cost rate	11.37	14.08	12.72
Surplus or deficit (as percent of program expenditures)	+1.64	−1.68	−.52 (−4.1)
Alternative III:			
Average cost rate	12.73	17.84	15.28
Surplus or deficit (as percent of program expenditures)	−.72	−5.44	−3.08 (−20.2)

Source: 1982 Report of OASDI Trustees.

Even absent any long-term financing measures by Congress, the cash-benefit programs are adequately financed for the next half-century. The reliability of estimates beyond 50 years are questionable at best. At worst, the projections for 50–75 years in the future have served as a rationale to make dramatic changes in the obligations of the nation's social insurance system. Because the system relies on the contributions of participants whose benefit obligations may not be paid for decades, I have opposed dramatic changes in social security's benefit obligations based on assumptions about what may or may not occur 50 to 75 years from now.

Nevertheless, I will support this committee's efforts to bring the OASDI programs within close actuarial balance along the lines of the National Commission agreement. As the provisions of the Commission agreement indicate, it is possible to close the 75-year financing gap without reductions in benefit protection.

When the long-range estimates are considered in perspective, it is not difficult to see how this is true. With no changes in current law, the average annual cost of OASDI is 14.09 percent of payroll over the next 75 years. During that time, the present law average annual contribution rate is 12.27 percent of payroll, leaving a deficit of 1.82 percent of payroll.

Virtually all of the deficit accumulates during the final third of the 75-year valuation period, when the estimates are the least certain. Moreover, the shortfall amounts to 12.9 percent of program expenditures. In fact, the closer one examines the long-term financing of social security, the more that claims of "impending calamity" and "intergenerational warfare" ring hollow.

Traditionally, the long-term cost of OASDI has been measured in terms of taxable payroll, which the Social Security Trustees believe will substantially shrink over the next 75 years. The Trustees' projections assume that cash wages (which are subject to the payroll tax) will decline from 84 percent of total compensation at present to 62 percent. However, if the cost of OASDI is measured in terms of the relative burden on current and future workers, it becomes clear that the cost of social security cash benefits will, on average, remain virtually the same as it is today.

For example, if it is assumed that the taxable wage base does not erode substantially (that workers continue to receive 84 percent of their compensation in the form of wages), then fully one-third of the entire long-term deficit (0.6 percent of taxable payroll) is eliminated. Under this assumption, revenues would increase enough to cover the benefit obligations projected under current law (about 14.0 percent of payroll). However, higher earnings credits would boost benefit obligations to about 15.2 percent of payroll, leaving a gap of 1.2 percent of payroll or about 7.8 percent of program expenditures—just outside the range of close actuarial balance.

On the other hand, if Congress were to adjust the payroll contribution rate for the erosion in the payroll tax base anticipated by the trustees, virtually the entire long-term deficit of the system (1.61 percent out of every 1.82 percent of payroll) is eliminated. Although this particular method of maintaining the system's revenue base at its current level would have negative income redistribution effects, I have included it as an illustration of how closely the current OASDI benefit structure conforms with our ability to finance it.

As a percentage of Gross National Product, the OASDI programs are remarkably stable over the long run. Under the alternative II-B assumptions, cost as a percentage of GNP dips from its current level of 5.16 percent to 4.97 percent in 1990, 4.53 percent in 2000 to a low of 4.35 percent in 2004. With the projected relative decrease in workers-to-beneficiaries, system costs begin to rise to 4.92 percent of GNP in 2015, 5.9 percent in 2025, and peak at 6.1 percent in 2030. Thereafter, the cost of OASDI drops steadily, reaching 5.44 percent of GNP in the year 2060.

The relative stability of OASDI costs as a proportion of GNP is shown by Table 3. Over the entire valuation period, the expenditures of the cash-benefit programs are projected to be 5.28 percent of GNP—roughly what they are today. Even under the pessimistic assumptions, the long-term cost of OASDI is 6.7 percent of GNP.

TABLE 3.—ESTIMATED COST OF THE OASDI SYSTEM AS PERCENT OF GNP BY ALTERNATIVE, CALENDAR YEARS 1982–2056

	Alternative			
	I	II–A	II–B	III
1982	5.07	5.08	5.16	5.19
2056	4.37	5.49	5.54	8.61
25-yr averages:				
1982–2006	4.25	4.40	4.75	5.25
2007–2031	4.67	5.11	5.30	6.50
2032–2056	4.70	5.67	5.78	8.34
75-yr average, 1982–2056	4.54	5.06	5.28	6.70

I would submit that much of the rhetoric surrounding this issue stems from a basic misunderstanding of how social security operates and is financed. It is impossible to read a newspaper or listen to the news without some reference to the "intolerable burden" of social security: how it will give young workers a "poor return" on their contributions, how it will claim an ever-increasing share of our resources, and how it could be replaced by a "sounder" system of private investment mechanisms. For this reason, I recently issued a report, "Social Security: Myth, Misconception and Reality," which I have included at the end of my testimony. I believe that it will help to show that the reports of social security's impending collapse are greatly exaggerated.

Mr. Chairman, this discussion of the system's long-range financing is intended to illustrate one simple fact: it is simply untrue that the benefit protection offered by social security constitutes an unwieldy burden for tomorrow's workers. While it is true that the workers of the future will not benefit from the artificially low contribution rates employed at the program's inception, it is also true that their relative payroll contribution burden will remain virtually what it is today. More importantly, the benefit protection promised to future workers can and should remain at the levels enjoyed by today's retired and disabled workers.

REPORT OF THE NATIONAL COMMISSION

On January 15, 1983, 12 of the 15 members of the National Commission on Social Security Reform agreed to issue, on a bipartisan basis, a series of recommendations to Congress which would: Completely finance the OASDI programs over the short term; finance more than ⅔ of the system's long-term deficit; and bring the system into range of what the actuaries consider close actuarial balance (projected revenues would fall into the range of projected costs plus or minus 5 percent).

This agreement was the product of the dedication and perseverance of Commission members from both political parties. In particular, the almost inexhaustible patience of Commission Chairman Alan Greenspan and the invaluable expertise of Executive Director Robert Myers enabled 15 members with extremely divergent and seemingly irreconcilable views to come to an historic political agreement. Largely through the tireless efforts of these men and other Commission members, including the Hon. Barber Conable, ranking Republican on this distinguished Committee, and former Commissioner of Social Security Robert Ball, the Commission came to an agreement on some very fundamental principles as well as to a package of refinancing proposals.

Principles endorsed by the Commission

During its lifespan, the Commission considered various alternatives to the present structure of social security. Such alternatives included a voluntary system, a system structured like a retirement annuity, and an advance-funded system. The Commission also considered proposals to substantially scale back benefit protection as provided under the present benefit formula. These proposals were rejected.

Instead, the Commission agreement is an endorsement of the fundamental principles on which the social security program was founded. These fundamental principles include: Benefits as replacement of lost earnings; receipt of benefits as a matter of right based on past contribution; primary financing through payroll contributions; avoidance of a means test as condition of benefit receipt; and for the common good, a balance between social adequacy and individual equity.

These principles are embodied in the Report of the House Committee on Ways and Means accompanying H.R. 6635, the Social Security Act Amendments of 1939 [1] which explained the importance of the contributory basis of social insurance:

"It is essential then that the contributory basis of our old-age insurance system be strengthened and not weakened. Contributory insurance is the best-known method of preventing dependency in old age by enabling wage earners to provide during their working years for their support after their retirement. By relating benefits to contributions or earnings, contributory old-age insurance preserves individual thrift and incentive; by granting benefits as a matter of right it preserves individual dignity. Contributory insurance therefore strengthens democratic principles and avoids paternalistic methods of providing old-age security. Moreover, a contributory basis facilitates the financing of a social-insurance scheme and is a safeguard against excessive liberalization of benefits as well as a protection against reduction of benefits."

The progressivity of the benefit formula and other social adequacy aspects of social security were incorporated into the original act by design. According to the 1935 Report of the Senate Committee on Finance accompanying H.R. 7260, the Social Security Act,[2] the social adequacy aspects of the program were to benefit the common good by lowering the costs of needs-based assistance:

"During the depression period the country has become keenly conscious of the problem of providing security for aged people who are without adequate means of support. Dependency in old age is a hazard which faces everybody."

"In view of the growing number of the aged, the great cost which title I (Old Age Assistance) is almost sure to entail in the future years, if no other provisions are made for old-age security, and the desirability of providing old-age security as a right and not as public charity, this bill proposes also inauguration of a system of Federal old-age benefits, computed on a reserve basis. Under this system it will be possible to pay annuities which will provide something more than merely reasonable subsistence. The benefits to be paid are related to the wages earned, but there are adjustments favoring the lower paid employees."

In reaffirming these fundamental principles, the Commission rejected proposals to alter the basic structure of social security for the same reasons that these alternatives were rejected at the program's inception.

A voluntary system was rejected as the antithesis of social insurance under which members of society pool their contributions against a variety of risks—death, disability, and retirement. Very simply, a voluntary program would not work. Adverse selection would drive the cost of a social insurance system to prohibitive levels, particularly for those who would most need its protection. As a consequence, many workers who need protections could not participate or would choose not to do so. Before the enactment of social security, millions of workers could not or did not make adequate provisions for retirement.

The Commission also rejected transforming OASDI into a simple retirement annuity, with benefits based exclusively on contributions. While benefits are related to contributions under the OASDI benefit formula, a progressive replacement rate in favor of lower wage workers exists. A pure retirement annuity system would result in insufficient or minimal protection for low-wage workers, workers who become disabled early in their careers, and survivors of workers who died at young ages.

Transforming OASDI into an advance-funded system was rejected in favor of the current pay-as-you-go approach. Dramatic tax increases would be required to build a fully-funded system. Moreover, the size of the fully accumulated trust fund would be approximately $6 trillion, roughly twice the nation's current Gross National Product. As Robert Myers indicated, such a fund would not only retire the accumulated Federal debt, but what was left would exceed the value of all the shares traded on the New York Stock Exchange and the American Stock Exchange combined. Under current law, the value of promised social security benefits is guaranteed by the authority of the Federal Government to continue to levy the payroll tax, and ultimately, its intention to honor those commitments.

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[1] H. Rept. 76–728, p. 6.

[2] Senate Report No. 74–628, pages 4 and 7.

This consideration was a factor in the Commission's decision to reject a reduction in the value of basic benefit protection. Under current law, the real value of social security benefits (known as the "replacement rate") will remain constant, absent action by the Congress. In 1977 Congress froze the OASDI replacement rate, which ensures that benefits in the future will replace a constant percentage of preretirement or predisability wages. In fact, the ultimate replacement rates which take effect in 1982 are actually lower than those in place during the previous nine years because of the "decoupling" of the benefit formula in 1977. However, they are roughly the same as those set by the 1939 Act.

The Commission agreement turned away from proposals to reduce the basic benefit level by lowering replacement rates by 5 percent, 10 percent or more. These proposals would have been implemented by altering the indexation of the formula "bend points" so as to reduce future real benefit levels. In addition to reducing benefit protection to levels which would have dramatically increased aged poverty, I believe that the "bend point" proposals constituted a surreptitious benefit cut.

Instead, the Commission agreed that the value of maintaining the social security program far exceeds the magnitude of its current financing problems. We concurred that the value of benefit protection to young workers—directly in the form of protection against the financial hazards of disability or death, and less directly in the form of a systematic way for them to help meet their responsibilities to support their parents and grandparents—is worth preserving and maintaining.

Proposals endorsed by the Commission

The Commission agreement represents a compromise for each of the 12 Members who were part of the agreement. Not a single member of the Commission would endorse every component of the package as an individual proposal. But as a package, as a bipartisan agreement, I believe it deserves the full consideration of this Committee and of the entire Congress, and I intend to work toward its passage.

The package represents a uniquely cooperative effort of members of diverse political factions. It entailed the cooperation of the President, the Speaker of the House, and the President of the Senate. Additionally, in the House, the agreement is supported by the majority and minority leaders, by the Ranking Republican of the Committee on Ways and Means and the Chairman of the Committee on Rules. In the Senate, it is supported by the majority and minority leaders, by the Chairman of the Committee on Finance, the Ranking Democrat on that Committee's Subcommittee on Social Security, and the Chairman of the Special Committee on Aging. The mainstream of labor and business groups, represented by the president of the AFL-CIO, the chairman of the board and chief executive officer of the Prudential Insurance Company, and the president of the National Association of Manufacturers, all support the Commission agreement.

The changes made in the Commission agreement are designed to make the social security system safe, solvent, sound and secure, for now and for future generations. The Commission agreement will provide the means to more than finance social security's obligations over the next few years, for the next half-century, and will bring the system into close actuarial balance over the long term.

Today's agreement turns away from the easy path of relying on hopeful assumptions to produce a solution. Such a solution might have fallen short of the amount needed to shore up the system if the recession continues. Instead, we have prepared for the worst in developing our recommendations. By doing so we can guarantee the viability of the social security system under virtually all contingencies. So while it will be considered strong medicine, today's agreement will go a long way toward restoring the trust of America's workers and retirees.

The Commission chose to avoid the mistakes of the 1977 Amendments, which relied on overly optimistic assumptions. Instead, the Commission used the 1982 Trustees' pessimistic assumptions, modified for recent economic trends, for projecting the short-term deficit. Under this "revised pessimistic" alternative III estimate, $173 billion in additional revenues would be required during 1983–89 in order to attain a trust fund ratio of 15 percent at the beginning of 1988. About $152 billion would be required to maintain an uninterrupted flow of benefits during 1983–89 under the same pessimistic assumptions.

Even if the economy performs according to the revised pessimistic estimate, the Commission package will contain sufficient funding to weather the storm. Approximately $168 billion during 1983–89 is provided by the consensus package. It is important to note that the cost estimates for the package were developed using the Administration's fiscal year 1984 budget assumptions. If economic performance is more in line with the revised alternative III estimate, the Commission package will raise $185 billion.

Finally, the package represents a fair and equitable sharing of sacrifice. Beneficiaries are asked to defer their cost-of-living adjustment (COLA) for six months. Those with the highest incomes will incur slightly higher income tax obligations; those at the low end will be protected from the COLA delay. Workers are asked to pay a 0.36 percent FICA tax increase during 1988 and 1989, and the self-employed are asked to pay more in payroll taxes only partially offset by an income tax cut. Even the general revenues will pitch in. In effect, everyone in America will give a little in order to get a lot.

Let me be more specific. Current beneficiaries of the system will continue to receive all of the benefits they are entitled to receive under current law, save for a one-time, six-month delay. As the Chairman of the Select Committee on Aging during the last 3 Congresses, I can share with this Committee exactly how much this means to the elderly people of this country. To these people, many of whom are primarily or entirely dependent on these benefits, social security is their lifeblood. The proposals made by some study groups, business leaders, Administration officials, Members of Congress and even the President to reduce these benefits created a climate of sheer terror for millions of elderly, widowed and disabled people. For many, the proposed reductions would have meant a difference in the quantity and quality of food, clothing, and medicine. The knowledge that these benefits will continue in their full amount will be a comfort to the elderly and disabled of America.

The Commission agreement is also a tremendous victory for the workers of America. Even as some elected officials were hiding behind promises to preserve benefits for current recipients, they were advocating massive reductions in benefits for today's workers. In order to achieve a short-term political gain by "protecting" today's elderly, they would bargain away the rights of tomorrow's.

These are the same politicians who were claiming that social security was a "bad deal" for young contributors. It is to take leave of common sense to suggest that reducing future benefit protection would somehow make social security a better deal. Mr. Chairman, nothing could undermine confidence in the social security system more than to renege on the commitments of the U.S. Government, simply because they will not be due for years to come. The decision of the Commission to preserve future benefit levels will avoid a major intergenerational conflict.

Elements of the Commission package

The Commission package includes six major short-run changes—a revised tax-rate schedule, general revenue reimbursements for military wage credits, extension of coverage, an increase in the self-employed tax rate, inclusion of 1/2 of OASDI in adjusted gross income for income tax purposes, and a shifting of the COLA to a calendar-year basis. The last four changes provide the bulk (1.36 percent of payroll) of the long-term savings. The cost impact of the Commission proposals resulting in savings or costs to OASDI are detailed in the table that follows:

TABLE 4.—SHORT- AND LONG-RANGE COST IMPACT OF COMMISSION PROPOSALS, SAVINGS TO OASDI

	Short-term 1983–89 (billion)	Long-term 75 yr. (percent of payroll)
Revenue changes:		
Extended coverage [1]	$23.0	0.30
Revised tax rate schedule	40.0	.02
Inclusion of OASDI in AGI	30.0	.60
Revise self-employed tax rate	18.0	.19
General revenue reimbursement	18.0	....
Net revenue changes	129.0	1.11
Benefit changes:		
Shift COLA to calendar year basis	40.0	.27
Equity changes:		
Windfall benefits	.2	−.01
Spousal benefits	−.5	−.07

TABLE 4.—SHORT- AND LONG-RANGE COST IMPACT OF COMMISSION PROPOSALS, SAVINGS TO OASDI—Continued

	Short-term 1983–89 (billion)	Long-term 75 yr. (percent of payroll)
Increased delayed retirement credit		−$0.10
Net benefit changes	$39.3	.11
Total savings	168.3	1.22
Additional long-range change	.58	

[1] Assumes revised tax-rate schedule. Assumed no change in retirement patterns. Substantial change would reduce projected cost or even result in net savings.

In addition to the items with major cost impact, there are equity changes in the areas of spousal and short-term worker benefits, delayed retirement incentives, and stabilization changes. The Commission agreement also covers 68 percent of the long-range deficit, leaving the remainder for Congress. For the purposes of discussion, these proposals are grouped in terms of their impact on OASDI revenues and OASDI benefits.

In the short run, just under 23.4 percent of the cost savings are attributable to changes in benefits. In the long range, however, the benefit reductions are somewhat offset by some benefit increases in the areas of spousal benefits and delayed retirement incentives. As a result, about 9 percent of the long-range savings are from benefit changes.

REVENUE CHANGES

Advance scheduled 1990 tax rate/make contributions partially income-tax creditable.—Prior to enactment of the 1977 Amendments, the financing status of OASDI was extremely critical both in the short run and the long run. Trust fund reserves were projected to maintain uninterrupted payment of benefits only through 1980, and the 75-year actuarial deficit was four times greater than the deficit now projected. A defect in the 1972 benefit formula which overcompensated persons becoming entitled to benefits after 1972 and insufficient real wage growth throughout the decade were the primary causes of the system's precarious state in 1977.

The 1977 Amendments addressed these problems primarily by correcting ("decoupling") the indexation in the 1972 benefit formula and by enacting a payroll tax increase apparently sufficient to guarantee the system's financing for the next half-century—an ultimate rate of 7.65 percent by the year 1990. The 1977 Amendments raised the tax in a series of steps—to 6.13 percent in 1979, 6.65 percent in 1981, 6.7 percent in 1982, 7.05 percent in 1985, and 7.15 percent in 1986—before reaching 7.65 percent in 1990. The intention was for each step of the scheduled increases to keep the system adequately financed—albeit barely—as system costs rose as a percent of payroll until 1990 when demographic conditions more favorable to the system's financing would result in large trust fund surpluses. The stepped-rate schedule of increases failed, however, to provide an adequate margin of safety to insulate the system against further economic downturns.

Earlier implementation of the 7.65 percent rate would have sufficiently financed the cash benefit programs through the next half-century. In view of the poor performance of the economic in recent years and the resultant precarious financial status, there appeared to be little justification for delaying the implementation of the scheduled 7.65 percent tax rate until 1990. As a compromise, the Commission agreement moves the 1985 OASDI contribution rate for employers and employees to 1984; retains the current law rate of 5.7 percent for 1985–87; reschedule the 1988–89 rate to 6.06 percent; and make not change in the tax rate for 1990 and thereafter. The following table compares the proposed tax rate schedule with current law.

TABLE 5.—OASDI TAX RATES: CURRENT LAW AND PROPOSED, EMPLOYERS AND EMPLOYEES, EACH CALENDAR YEARS, 1983–90

[In percent]

	Current law	Proposed change
1983	5.4	5.4
1984	5.4	[1] 5.7
1985	5.7	5.7
1986	5.7	5.7
1987	5.7	5.7
1988	5.7	6.06
1989	5.7	6.06
1990	6.2	6.2

[1] To be offset with refundable income tax credit.

Commission members appointed by the Democratic leadership had insisted on a refundable tax credit in order to neutralize any change in the individual workers' tax burden. Other members were strongly opposed to such a credit. As a compromise, we agreed to recommend that a refundable income tax credit offset the 1984 payroll tax increase, but not the tax increase scheduled for 1988 and 1989. I strongly urge this committee to retain the income tax credit at least for the tax increases scheduled for 1988 and 1989, and to consider a permanent income tax credit for any rate increase beyond the current 5.4 contribution rate. Such a credit would have no impact on the unified budget. If OASDI is removed from the unified budget, the tax expenditure could be offset by a partial repeal of the indexation of the income tax scheduled to take effect in 1985.

This recommendation will be a major step towards correcting an anomaly in the tax code under which (with minor exceptions) employee contributions to retirement and disability systems, including OASDI, have been made from after tax income. This has applied to contributions for both private pension plans and social security. The result of this anomaly is that a young couple trying to raise a family, buy a house, and meet other expenses from the lower salaries usually available to younger workers is also transferring a substantial amount of income to retired people and is paying income tax on the amount transferred.

Recent legislation to enact and to expand vehicles for private retirement savings have acknowledged this anomaly by creating "individual retirement accounts" (IRA's) into which workers can build a source of retirement income through pre-tax contributions. The tax treatment of IRA Contributions reflected the concern that young workers need not be strapped with the twin burdens of deferring needed income for decades while being taxed on that income. I believe that this concern should prevail in the context of workers' contributions to social security. Changing the tax treatment of OASDI contributions would properly align it with the tax treatment of IRA Contributions and significantly contribute toward better coordination of the nation's retirement income policies.

Extension of coverage to Federal and nonprofit employees for all new hires.—Social security coverage is compulsory to all gainfully employed individuals in America except civilian employees of the Federal government, employees of State and local governments, and employees of non-profit organizations which have elected to "opt out" from providing coverage. Employees of the Federal government were originally excluded from social security because they were already covered by the Federal Civil Service Retirement system.[3] State and local government employees were exempted from compulsory coverage because of the uncertainties caused by the possible applicability of the constitutional prohibition against taxation of the States by the Federal government. Employees of nonprofit organizations were exempted because their employers were exempted from Federal income taxes.

With these exceptions, 95 out of every 100 Americans today are insured against the loss of earnings on which they are dependent through social security coverage. The failure to completely extend coverage throughout the workforce has created problems associated with gaps in survivor and disability coverage and inequities associated with the manipulation of various benefit formulae in order to gain favorable treatment in relation to the social security-covered workforce. The Commission believes, in principle, that every gainfully employed American should be covered by social security. Specifically, the Commission is recommending extension of coverage, effective 1984, to all new employees of the Federal Government, and to all employees of non-profit organizations.

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[3] References made to the Federal Civil Service Retirement system include other plans covering Federal employees such as the Foreign Service and Central Intelligence Agency plans.

Nonparticipation in social security is advantageous to a small, albeit visible, segment of the recovered population. By and large, these are highly-paid, long-service participants in the Federal Civil Service Retirement system (or other nonintegrated Federal plan) who spend a relatively short time performing social security-covered work. For them, the noncoordination of social security and pensions based on noncovered work results in the receipt of what is commonly known as "windfall" social security benefits. In addition to receiving retirement annuity benefits substantially larger than the average OASI benefits (as is the case with Federal CSR and many nonintegrated Federal government plans), these dual beneficiaries receive OASI benefits which reflect the heavy weighting of the benefit formula intended for low-wage earners.

This advantage comes at the expense of millions of noncovered employees who are deprived of all or much of the valuable social insurance protection provided under the social security system. Even the Federal Civil Service Retirement system—considered the best of plans for noncovered workers—cannot match the package of family, survivor and disability benefits offered by social security.

Social security provides family benefits to replace the lost earnings of retired and disabled workers. Family benefits are paid to aged spouses, unmarried dependent children, and spouses caring for eligible children, based on the retired or disabled worker's earnings record. Social Security provides survivor benefits for spouses, children and dependent parents—whether the worker is active or retired. Social security disability protection is, in general, unmatched by other government plans, especially with respect to low- or average-earnings workers.

Nonparticipants in social security also lack most or all of these important protections: Portability of earnings credits; wage-indexation of earnings credits; tax-exempt status of benefits; complete inflation protection of initial benefits; nonforfeitability of spouse protection; and weighting of the benefit formula to protect workers with low, average or noncontinuous earnings histories.

Finally, nonparticipation in social security undermines confidence in the system from the standpoint of the contributing worker. It has long been a source of resentment and confusion to covered workers who observe that the people who are entrusted with making program policy, managing the program, and carrying out its operations on a day-to-day basis are themselves exempted fróm coverage. The Commission recommends that the social security program should, by and large, cover every American worker including the President, Vice-President, Members of Congress and Federal Judges.[4]

In short, the Commission believes that permitting continued nonparticipation in social security by this significant portion of the population is poor public policy from an equity, adequacy, and perceptual point of view. Universal coverage would end the real and perceived inequities associated with "double dipping," restore confidence in the social security system, and ensure that no American be denied valuable protection from the loss of their earnings because of retirement, disability or death.

I would emphasize that I am opposed to the termination of the Federal Civil Service Retirement system or any other nonintegrated public employee system. I believe that the benefits offered under these plans are part of the total wage package needed to induce workers into government employment and are a reward for years of dedicated public service. These plans should exist as a tier to supplement the basic social insurance protection provided by social security, as private plans do, and should continue to offer benefits which, when considered in combination with social security, offer the same aggregate level of protection offered currently by the Federal Civil Service retirement system.

Extending coverage in the manner the Commission has proposed, exempting only Federal Government employees hired before 1984 would expand the OASDI revenue base significantly while preserving the rights of current noncovered employees and the long-term interests of future employees. Universal coverage also results in significant long-run savings, which are the net of expanded payroll tax receipts minus increased benefit obligations. The greater magnitude of the former is a function of the fact that current benefit obligations to these groups are substantially greater than current payroll tax receipts (because of the different benefit formulae). This proposal will result in increased revenue to the combined OASDI trust funds of $23 billion by 1991, and an excess of tax receipts over benefits equalling 0.30 percent of payroll over the 75-year valuation period.

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[4] For Constitutional reasons, the Commisison did not recommend mandated coverage of State and local government entities.

Additional coverage issues.—Employees of State and local governments may be covered under social security at the option of the State and in agreement with the Secretary of Health and Human Services. Coverage may be terminated if the State gives 2 years' written notice of such intent. Notice can only be given after a State or local group has been covered for at least 5 years. Once coverage is terminated, the group can never again be covered under social security.

During 1959-1981, 881 State and local government entities, school systems and hospitals have "opted out" of social security. Of that total, 606 terminated coverage after 1975. Fueled by concern over the system's financing and proposed reductions in benefit protection, the relatively small number of withdrawals has substantially increased. In 1981 alone, more than 100 entities, representing 172,000 employees, terminated coverage. These 1981 withdrawals alone will cost the OASDI trust funds $200-$250 million annually, entities are pending for the next 2 years. If all 9,000,000 employees of State, county and city governments, school systems, hospitals and other employees of non-profit organizations terminated coverage, the cost to the trust funds would be $18 billion annually.

The Commission proposes to no longer permit State and local governments which have elected social security coverage for their employees to terminate such coverage. In addition, pending termination notices would be invalid.

The Commission recommendations also close a loophole which permits employers to reduce their FICA taxes under "salary reduction" plans. Section 401(k) of the internal revenue code allows employers to set up a plan in which employees can opt to have a portion of their pay set aside in a tax-sheltered fund. In addition to the income tax exemption, the deferred salary is also exempt from the payroll tax. As a result, participants in such plans receive smaller earnings credits and revenue is lost to the trust funds. The Commission recommends that, for both the payroll tax and earnings credit purposes, any salary deferred under a Section 401(k) plan be considered as cash wages.

Equalize self-employed tax/make contributions partially income-tax deductible.—All covered workers make contributions at a combined employer-employee rate on 13.4 percent of their taxable payroll. Self-employed workers, who pay only 75 percent of the combined OASDI contribution rate and 100 percent of the HI contribution, comprise the sole exception to this rule. At the time self-employed persons were brought into the system, this exception represented a compromise based on two considerations. The rate reflected a political compromise between those who believed the contributions of the self-employed should not exceed that of any other employee and those arguing that since the self-employed receive the same protection as all other workers they should be equivalent of the employee-employer contribution. Secondly, the tax code allows deductions of business expenses (including payroll contributions on behalf of employees) in figuring a corporation's income tax. Since self-employed persons in unincorporated businesses were unable to take advantage of this business deduction, a rate less than 100 percent of the combined employer-employee tax was considered equitable. This has the unfortunate effect, however, of systematically reducing revenues to the social security program.

In the past, proposals to equalize contribution rates between employees and the self-employed would have dramatically increased the out-of-pocket burden on self-employed workers because no compensating treatment in the tax treatment of the payroll tax contribution was advanced. The Commission believes that the time has come to prevent the further loss of income to the program by equalizing the contribution rates without causing undue hardship to the self-employed. The Commission recommends that, beginning in 1984, one-half of the self-employed workers' contribution become income-tax deductible and that the contribution rate for self-employed workers be equalized with the combined employer-employee contribution rate. The combined impact of these two recommendations will ensure that self-employed individuals are not faced with a substantial increase in their tax liability. This will result in additional revenues to the combined OASDI trust funds of $18 billion by 1989/1991 and 0.19 percent of payroll over the next 75-year valuation period.

Partial inclusion of OASDI benefits in AGI for income tax purposes.—Social security benefits have been excluded from gross income for purposes of income tax under a series of rulings in 1938 and 1941 by the Internal Revenue Service. The tax-free treatment of OASDI has received widespread public support, largely because the contributions of employees and the self-employed were already taxed at the time they were made.

In 1979, the quadrennial Advisory Council on social security recommended that one-half of OASDI benefits be subject to the income tax, on the grounds that the employer contribution was not taxed when made. Largely because of the misperception that this change would result in higher tax liabilities for low-income beneficiaries, the proposal was soundly rejected. Indeed, as Chairman of the Select Committee on Aging, I recall how the terrified response of low-income elderly and disabled social security recipients constituted the strongest opposition to the proposal. Ironically enough, these were precisely the people who have remained unaffected.

In recognition of this widespread perception, the Commission recommended that one-half of OASDI benefits be included in adjusted gross income only if other adjusted gross income exceeded the following thresholds: $25,000 for a joint return and $20,000 for a single taxpayer or a married taxpayer filing a separate return. As currently constituted, this provision would affect only 11 percent of the aged population—those with the highest incomes.

Even for this highest-income segment of the elderly population, the additional tax burden will be unduly onerous. For a single, aged taxpayer with AGI of $30,000 and a $500 a month benefit, the additional income tax would be 1.9 percent of total income. For a married elderly couple with AGI of $40,000 and a $1,093 benefit, the additional tax liability would be 2.7 percent of total income.

Two major problems with the Commission recommendations as currently constituted remain, however. The first pertains to a "notch" which exists between persons with incomes just above or just below the thresholds. Theoretically, the difference between two individuals with identical OASDI benefits and adjusted gross incomes of $19,999 and $20,000, respectively, is an additional $500 or more in tax liability for the latter.

We are all too familiar with the consequences of the "notch" created by the 1977 Social Security Amendments. I know that this Committee will act to ensure that individuals in similar circumstances are not treated substantially differently. A possible method for "smoothing out" the notch would include one-half of OASDI benefits in AGI, and subject those benefits to the income tax to the extent that they exceed the threshold.

An additional problem lies with the implementation of the proposal; that is, the manner in which the taxes are to be collected. Although Congress might be tempted to withhold a portion of benefits in order to satisfy the new tax liability, this would be perceived as a benefit reduction.

In order to ensure that the purpose of the proposal remains clear, I would urge this Committee to adopt the approach in S. 1, the Social Security Amendments of 1983. Under S. 1, the Secretary of HHS would be required to file information returns, similar to the W-2 form, detailing the payment of OASDI benefits during the taxable year. The individual would then include a copy of the form with his or her tax return.

Under this approach, the OASDI trust funds are prospectively reimbursed by the Secretary of the Treasury. The Secretary would transfer (on at least a quarterly basis under S.1) to the OASDI trust funds an amount estimated to equal the increased taxes raised under the proposal.

Accelerating general fund debt repayment for past military wage credits.—Since 1946, the Congress has enacted no less than nine specific legislative provisions which provide that persons serving in the military service of the U.S. shall receive special social security wage credits in excess of the actual amount of the person's military salary. However, no payroll taxes are levied on these special wage credits even though they are considered the same as other wages when benefits are computed and, therefore, raise the benefit costs of the program. Two types of credit were provided:

Pre-1957 wage credits.—World War II veterans were givern noncontributory wage credits of $160 for each month of active military service. These credits were provided to protect veterans from losing social security coverage during their military service. This type of credit applies to military service from 1940 to 1957. Since 1977, the General Fund of the Treasury has paid the OASDI funds $446 million a year as reimbursement for the estimated benefit costs of granting special non-contributory gratuitous wage credits for military service prior to 1957. Under current practice, the trust funds will continue to receive these level payments of $446 million a year until the General Fund obligation of $17 billion owed to the OASDI trust funds is fully repaid in the year 2015.

Post-1956 wage credits.—Noncontributory wage credits of $300 per quarter for military service performed after 1956 to recognize the value of non-cash compensation such as food, shelter and medical services. In 1981 the General Fund paid the OASDI trust funds $74 million for the estimated 1981 costs of benefits based on noncontributory gratuitous credits for military service after 1956. If the general fund reimbursement had been based on the amount of payroll tax revenues which would have been paid, based on the amount of gratuitous earnings, it would have been about $130 million short of the revenues the trust funds could have received had the gratuitous wage credits been subject to the same FICA tax as real wage credits.

The Commission recommendation would credit the OASDI trust funds with the present value of the estimated additional benefits arising from the pre-1957 gratuitous military wage credits. For gratuitous wage credits from 1957 through 1982, the trust funds would be credited with a lump sum equal to the combined employer-employee taxes which would have been levied and the interest which would have accumulated, less the reimbursements already received. In the case of wage credits for noncash compensation in 1983 and beyond, the value of the employer-employee contribution on such credits will be credited annually to the appropriate trust fund.

Reimbursement for value of unnegotiated checks.—The U.S. Treasury, manager of the OASDI trust funds, debits the trust funds for the amount of each month's benefit payments at the time they are paid rather than after they are cashed. This leads to the premature debiting of billions of dollars each month which reduces interest income and limits the flexibility of the trust funds to respond to the current cash flow problems. As a result, the OASDI trust funds have lost approximately three-quarters of a billion dollars, representing the value of debited benefit checks which have never been cashed and the value of interest lost.

Currently, the day that benefit checks are dated, usually the third of each month, is the day that the major drawing down of the trust funds is set into motion. On that day, securities equal in value to that portion of benefits paid by direct deposit—approximately one third of total benefit payments or about $4.7 billion—are redeemed by the Treasury. The remaining sum needed to pay the month's benefits is produced when additional securities held by the trust funds are liquidated two days later (usually the fifth of the month). This practice results in the trust funds being debited for 100 percent of all benefit payments with 2 days of the first date of redemption, even though less than half would have been presented for payment by that time. In fact, the SSA does not even consider a check to be late until three days after the delivery date, and no action is taken to follow up or replace lost checks until the sixth of the month.

The Commission recommends that the value of uncashed OASDI checks issued in the past be credited to the trust funds in a lump-sum payment. For uncashed checks in the future S.1 would require the Secretary of the Treasury to "take such actions as may be necessary" to ensure that the trust funds are credited on an ongoing basis. I would recommend that the Treasury Department's flow of funds procedure be changed to ensure that the OASDI funds are debited after the checks are cashed rather than issued. This requires that the amount of benefits paid by electronic transfer be debited after recipient institutions make their demand for payment from the Federal Reserve.

Instituting these recommendations will not only assure that the Trust Funds are treated fairly, but will also result in a smoother level of disbursements throughout the month. Obviously, in order to facilitate this process, the Treasury could project the rate and level of disbursements and reconcile these estimates on an annual basis. A similar technique is already used for crediting FICA revenues.

Shift cost-of-living adjustment to calendar year basis/Increase SSI disregard.—One of the most important elements of the social security system is the mechanism which maintains the purchasing power from the point of entitlement throughout a beneficiary's lifetime. The COLA ensures that the amount of goods and services that can be purchased by the monthly benefit will not be reduced because of inflation.

The COLA has been a popular target for budget cutters recently. Because of the COLA, they claim, the income of beneficiaries grows faster than those of workers. I have even heard some critics say that the COLA increases benefits faster than inflation. Would that these claims were true, the income status of America's poorest age group—the elderly—would be much better than it is today.

The plain truth is that the COLA simply preserves the value of the initial benefit. Wage growth has outstripped price growth for 28 out of the last 36 years, and it will continue to do so under all sets of assumptions.[5] So all of this talk about trimming the COLA in order to "slow the growth of benefits" is nonsensical doubletalk. When you cut the COLA, you are cutting benefits.

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[5] For a more complete discussion of these issues, see "Cost of Living Adjustments Under the Old Age, Survivors and Disability Insurance Program," U.S. House Select Committee on Aging, April 23, 1982.

Many on the Commission wanted to do just that. Proposals were made to pay three-quarters or one-half of the CPI. Other proposals would have paid the CPI minus 2 or 3 or 4 percentage points. Finally, there was a great deal of discussion to peg the COLA to "wages minus X," whatever that is.

Others on the Commission, myself included, refused to go along with these proposals to alter the basis on which the COLA is paid. The Commission recommendation represents the resultant compromise.

The agreement proposes shifting the COLA to a calendar year schedule. Beginning in 1983, the COLA would be calculated on the December benefit (payable in January), rather than the June benefit, payable in July. In addition, the measuring period would also be shifted, in 1984, so that the adjustment would continue to come 3 months after the end of the CPI measuring period.

What this provision really means to the vast majority of aged and disabled beneficiaries is an additional six-month wait before their next regularly scheduled benefit adjustment. Instead of receiving the COLA in July, 1983, their checks will not be adjusted until January of 1984. In effect, they have lost the COLA for 6 months. Although the rate is adjusted thereafter, the lost purchasing power will never be recouped.

Mr. Chairman, no one can claim that the current beneficiaries of social security will not adequately share in the sacrifice needed to obtain this agreement. The COLA delay will cost the average retired beneficiary, now receiving about $400 a month, about $120 in 1983. During every year that beneficiary remains on the rolls, he will lag $120 (in real terms) behind the inflation-adjusted value of his current law benefit.

Fortunately, the very lowest-income beneficiaries will be shielded from the impact of the COLA delay. As part of this proposal, the monthly disregard of social security benefits under the supplemental security income program will be increased from $20 to $50. SSI pays general revenue-funded benefits to the neediest aged, blind and disabled. Therefore, the OASDI beneficiaries who fall into those categories—generally the very poorest—will receive an increase in SSI slightly larger than the lost cost-of-living adjustment.

I regret the appearance in this package of even this one-time six-month delay in the cost-of-living adjustment. It is my hope that the elderly and disabled will consider it as a heavy but necessary toll for achieving a politically workable and financially viable social security system.

Equity changes—spousal benefits.—Strictly speaking, the OASDI program is gender-neuter; persons entitled to benefits as a retired worker, disabled worker, a spouse, a disabled or divorced spouse, a surviving spouse, a child, a surviving or disabled child, or a parent regardless of sex. Substantial changes in women's roles in society have resulted in various adequacy and equity concerns for women beneficiaries, however. Although the Commission did not broadly address itself to these concerns, the Commission's recommendations include some low-cost, well-targeted benefit changes to address some of the groups most in need. Among them:

Remarried divorced or disabled widow(er)s.—Benefits would no longer be terminated upon remarriage if the marriage occurs after the age of first eligibility for benefits. Disabled widow(er)s' benefits and disabled surviving divorced spouses' would be payable to those who remarry after age 50; surviving divorced spouses' benefits would be payable to those who remarry after age 60.

Deferred survivors.—Benefits would no longer be based on outdated wage records. Under the proposal the earnings credits of the deceased worker would be indexed to reflect economy-wide wage increases instead of price increases.

Divorced spouses.—Benefits would be payable at age 62 to divorced spouses (who have been divorced for at least two years) of eligible former spouses, irrespective of whether the worker has claimed benefits.

Disabled widows and widowers.—Benefits would be increased to 71.5 percent of PIA at age 50, the age of first eligibility. Currently, benefits are payable on a graded scale, increasing from 50 to 71.5 percent of PIA at ages 50 to 60.

These proposals are modest in the context of the entire agreement, but they will make life a little less harsh for some groups of women in the most dire economic circumstances. These changes are long overdue, and I am pleased to support them.

Equity changes: windfall benefits (elimination of short-term worker advantage for non-covered workers).—The social security benefit formula is based on the dual concepts of individual equity and social adequacy. Individual equity is achieved by linking benefit levels to the amount of taxable earnings—i.e., higher levels of earnings result in a greater amount of benefits. Social adequacy is attained through a progressive benefit formula—i.e., higher levels of earnings result in proportionally smaller increases in benefits. Therefore, while the $275 monthly benefit currently paid to a 62-year-old lifetime minimum wage earner represents 47.2 percent of final earnings, the considerably larger $509 benefit paid to a 62-year-old maximum worker represents only 20.6 percent of the previous year's maximum earnings.

The current benefit formula is designed to replace an individually equitable and socially adequate proportion of the lifetime earned income of workers who spend their entire paid work careers in social security-covered employment. This formula, however, cannot distinguish between workers who have covered and non-covered work histories. Therefore, similar benefits will be paid to a person who earns $10,000 for 35 years and another person who earns $35,000 for 10 years, regardless of whether the short-term, higher paid worker is also eligible for benefits based on work in non-OASDI-covered employment. In these circumstances, individuals who did not spend their full paid work career in OASDI-covered employment receive an unintended windfall due to the graduated nature of social security's progressive benefit formula. For example, a 62-year-old OASDI-covered worker with a full working career[6] of 26 years of average earnings credited to his/her social security record since 1951 currently receives a benefit of $402. A 62-year-old short-term worker with 13 years of average earnings posted to his/her record since 1951 (half a full career total) receives a benefit of $240 or 59.7 percent of the full-career worker's benefit. Eight and three quarters years of average earnings (one-third of a full career) yields a benefit of $196 or 48.8 percent of an average full-career benefit.

In order to rectify the specific anomaly whereby workers who split their working careers between OASDI-covered and non-covered work receive an unintended advantage, the Commission recommended 2 possible revisions for persons who become eligible for pensions from non-covered employment in 1984.

Unfortunately, the method adopted in S. 1 is the harsher alternative, identical to the proposal submitted by the Administration in May, 1981. This proposal simply and arbitrarily eliminates the 90 percent replacement rate applicable to the lower band of average indexed monthly earnings. Instead, the second percentage factor of 32 percent would apply. As detailed in a report issued by the Select Committee on Aging,[7] this proposal would result in substantial and arbitrary benefit reductions, having little to do with the extent to which a worker relied on non-covered earnings to finance retirement income.

The alternative method presented in the Commission report is far preferable. Under this approach, earnings from both covered and non-covered work would be applied to the present benefit formula in order to determine the replacement rate. That replacement rate would then be applied to a worker's covered earnings. This approach was recommended by the Hon. J. J. Pickle, Chairman of the Subcommittee on Social Security, in his social security financing legislation in the 97th Congress.

Increased delayed retirement credit.—As an alternative to those who would mandate an increase in the age of entitlement, the Commission recommended a long-overdue incentive for workers to postpone retirement. Under current law, a worker receives a bonus equal to an annual rate of 3 percent for each year between ages 65 and 70 that retirement is postponed. This 3 percent bonus, the delayed retirement credit, was considered too insignificant to influence any retirement decision.

Under the Commission agreement, the very slight incentive offered by the present-day delayed retirement credit would be substantially increased. During the years 1990 and 2010, the bonus would be gradually increased from 3 to 8 percent. When fully phased in, a worker would receive 140 percent of his primary insurance amount at age 70, as compared to 115 percent under current law.

Although this proposal is estimated to cost 0.10 percent of payroll in the long run, it is assumed that this proposal will not substantially alter the retirement patterns of older workers. If the incentive does induce a significant number of workers to delay their retirement, however, the cost of the proposal would be much smaller. Moreover, if the incentive is very successful, substantial net savings to the system could result.

Attempts have been made to force older workers to remain in the work force longer. Ironically enough, due to both the current recession and decades of age discrimination, unemployment among older workers has never been higher. All that is accomplished with the approach of coercion is a harsh reduction in the benefit protection of millions of older persons who, for reasons of health, can no longer remain in the work force. I wholeheartedly support the voluntary alternative contained in this recommendation.

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[6] Full working career is defined as the number of years in the benefit computation formula. For someone reaching 62 in 1982, a full working career is 26 years. This will increase by one each year, until reaching 35 in 1991.

[7] Impact of the Administration's Social Security Financing Proposals on Current and Future Beneficiaries, Select Committee on Aging, U.S. House of Representatives, Ninety-Seventh Congress, First Session, July 1981.

STABILIZING CHANGES

Perhaps the greatest challenge to maintaining continued confidence in the system will come from the impact of economic trends on short-run program financing. Over the long run, benefit and contribution levels relative to each other have a high degree of predictability because they are both tied to the growth of wages. Given a particular set of demographic assumptions, the relationship of income to outgo over the long run lends itself to a high degree of predictability.[8] In the short run, however, the extreme sensitivity of the system to the economy places a considerable limit on the predictability of actuarial soundness during periods of poor economic performance. Most of the system's sensitivity can be traced to the indexation of cash benefits to price increases upon entitlement.

Ironically, indexation of cash benefits was an effort to stabilize the financing of the OASDI system. Asssuming demographic stability and a constant tax rate, the variable affecting contributions to the system would be linked to factors affecting system outlays. With a worker-beneficiary ratio stabilized at 3:1 as the system matured growing wages would boost contributions at the same rate that they increased earnings records resulting in concurrently higher outlays. The sole exception to this symmetrical relationship was price indexing of benefits upon entitlement.

At the time of its enactment as part of the 1972 amendments, providing a cost-of-living adjustment indexed to prices was adopted as a cost-reduction alternative to wage indexing. Wage increases had outstripped the CPI in virtually every year prior to the 1972 amendments, and no set of assumptions projected negative wage growth. By all estimates, indexing the cost-of-living adjustment to increases in wages would have resulted in higher benefit outlays over the long term.

Beginning in 1974, however, the U.S. economy began a period of protracted negative wage growth. Between 1974 and 1979 the CPI outstripped wage increases an averaged of 0.3 percent; in 1980 prices exceeded wages by an unprecedented 4.9 percent. As a result, system disbursements exceeded income for the first time in the history of the program during 1975 through the present.[9]

This phenomenon highlights the dramatic impact of indexing post-entitlement benefits to the CPI while other factors affecting system income and outlays are wage indexed: the OASDI trust funds become extremely sensitive to the economy in the short run. All other things being equal, periods of real wage growth (a "normal" economy) result in net annual surpluses in the relationship between income and outgo. This is because contributions (tied to wages) rise at a faster rate than benefit payments (tied to wages and prices). Conversely, during periods of economic contraction, relatively higher prices will boost outlays at a rate faster than payroll tax revenues.

This sensitivity to the economy is accountable for much of the uncertainty which characterizes short term financing considerations. For example, under the midrange (intermediate II-B) assumptions, $61 billion would be sufficient to maintain the timely payment of benefits between 1982 and 1991. However, under the pessimistic set of assumptions, more than $152 billion would be required. According to the optimistic set of assumptions, no additional funds would be required because the OASDI trust funds would remain in surplus (and would continue in surplus status during the entire 75-year valuation period).

This substantial range of short-term possibilities was the most intractable facing the Commission. By the best estimates, the cash-flow problems facing the OASDI in the short run will amount to only 2 or 3 percent of program expenditures. If the mid-range economic assumptions prove correct, relatively minor or incremental charges would be sufficient to maintain an adequate cash flow. However, the possibility of a sustained recession, or that the economy would perform according to the pessimistic assumptions, would increase the magnitude of the shortfall. Given the system's sensitivity to the economy, accepting these prospects as inevitable would lead the Commission to the conclusion that only a dramatic, permanent reduction in social insurance protection could provide the "margin of error" needed to "restore confidence" to the system.

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[8] The demographic assumptions themselves (particularly with respect to trends expected to occur during the last third of the 75-year projection period) are subject to a wide range of variation.

[9] This is also attributable to an error in the indexed benefit formula enacted in 1972 which compounded wage and price increases. The 1977 "decoupling" amendments corrected the flaw, but not until after 5 years of new beneficiaries received unintended benefit increases and not until an additional group of persons becoming entitled between 1977 and 1981 received a transition guarantee.

Rather, the Commission believed that a mechanism for insulating the OASDI programs from the temporary shocks of the economy is far preferable to locking in the kind of major benefit reductions which anticipate severe economic downturns that may never occur. In effect, the course the Commission is recommending will enable the program to weather periods of poor economic performance with adjustments which affect worker and beneficiary alike, without penalizing either worker or beneficiary if pessimistic economic assumptions do not materialize.

The Commission agreed to a package of three stabilizing proposals, but could not come to an agreement on perhaps the most important element: a "fail safe" proposal.

The three proposals for stabilizing the system include:

Wage-based COLA trigger with repayment mechanism.—Beginning in 1988, whenever the OASDI trust fund reserves fall below 20 percent of the next year's outlays, the COLA would be based on the lower of wage growth, or the increase in CPI. When the fund ratio returns to 32 percent or more at the beginning of a year, benefits based on full CPI increases would be reinstated and amounts foregone in previous years would be repaid.

Reallocation of OASDI tax rates.—Under the Commission proposal, part of the DI tax would be reallocated to the OASI trust fund in order to achieve roughly the same trust fund ratios for each. Similar reallocations took place as a result of 1980 legislation and the 1977 Amendments.

Temporary OASDI-HI interfund borrowing.—Through 1987, authorize interfund borrowing between the OASI and DI trust funds and from the HI trust fund.

I would have preferred stabilization proposal which relied entirely on new revenues. The combined effect of the Commission package would build the trust fund reserves to the 30 percent level—far above the trigger level for a wage-based COLA. In fact, even under the pessimistic assumptions, OASDI benefits are adequately financed in the short term.

Without a fail-safe measure and certain other refinements, however, the stabilizing package does not go far enough. Even the pessimistic estimate assumes a "straight-line" performance of economic indicators from 1983 through 1989. Our cyclical economy, however, is characterized by peaks and valleys. Although the Commission agreement would adequately finance the near-term shortfall in aggregate, it is possible to run into a cash-flow problem (particularly in 1984–86, when revenues raised are the least). Such a cash-flow problem, no matter how minor in the long run, would severely damage the credibility of the system, the Commission and most importantly the government.

I am therefore strongly urging this Committee to adopt the following proposals, which I will describe below.

Permit permanent interfund borrowing.—The Old Age and Survivors' Insurance trust fund assets are maintained separate and distinct from those of the Disability Insurance trust funds. This practice stems from the enactment of the DI program in 1956, when concerns arose that unexpectedly high costs for the new program might adversely affect the OASI program. Although these concerns never materialized, Congress maintained separation of the funds in order to discourage the perception that the OASI trust funds were being "diverted" to pay for DI benefits.

For the purposes of financing, however, Congress is primarily concerned with the tax rate for the cash-benefit programs in aggregate rather than the specific allocation of the total tax rate between the two funds. This arrangement served well during previous years, when the tax rates exceeded, with a significant margin for error, the amount required to finance the obligations of each program respectively.

With the maturation of the program into a fully pay-as-you-go system, the combined tax rate is ideally sufficient to finance the benefit obligations of both programs and allow for a small excess to build the trust funds as a contingency reserve. Because the factors affecting income and outgo are not identical for both programs, it is possible for one trust fund to be drawn down precariously low even while the other builds up substantial reserves—all during a time when the combined tax rate is sufficient to finance the OASDI programs. When this occurs, the present arrangement requires an act of Congress to reallocate the tax rates—action which is inevitably accompanied by heavy media attention and needless public concern.

The most recent case in point concerned the 1977 trustees' report projections of imminent exhaustion of the DI trust fund. Ironically, the actual performance of the DI program was so much better than the dire projections assumed it would be that a substantial portion of the DI payroll tax was diverted to the less stable OASI fund.

Yet this reallocation, the result of a law passed by Congress in 1980, was the cause of widespread public concern.

During periods when the combined payroll tax is sufficient to finance both the OASI and DI programs but one of the funds is low, the necessity for Congressional action to readjust the payroll tax incites scare headlines and causes needless fear among the general public. Moreover, the reallocation of payroll taxes is as mechanically imprecise as it is politically cumbersome. I believe that a mechanism which would allow fine-tuning of revenue allocations between the trust funds is necessary to avoid subjecting the public to political demagoguery and scare tactics when the reserves of one trust fund are ample and those of the other are low.

Starting in 1983, the OASI and DI trust funds should be permanently authorized to borrow from the other whenever needed to assure timely payment of benefits, with the loans made repayable with appropriate interest.

I would acknowledge the necessity of maintaining a separate accounting of the revenues and benefit obligations of OASI and DI. Information from such cost analyses and estimates is needed to enable policymakers and the public to track possible adverse trends in either program. While such separate accounting allows sound program planning and management, I believe that the adverse effects on public confidence outweigh the negligible benefits of requiring legislative action to reallocate taxes between the cash benefit trust funds. Because the factors affecting the expenditures of the Hospital Insurance program—medical costs and utilization—are fundamentally different and substantially more volatile than those affecting the outlays of the cash benefit programs, I do not believe that the HI trust fund should be included in the permanent interfund borrowing arrangement after 1987.

Countercyclical general revenues.—The combination of financing mechanisms recommended by the National Commission is sufficient to address social security's cash flow problem even if the pessimistic economic projections materialize. One such mechanism which will help to insulate the system against economic shocks by relating the cost-of-living adjustment to wage growth has been outlined above.

There remains the possibility, albeit remote, that the economy will perform even worse than the pessimistic set of assumptions. There is an additional possibility, that economic fluctuations will result in temporary periods of performance less favorable than the assumptions. In recognition of this possibility, I believe that:

(1) It is desirable to have an additional stabilizing mechanism in place to deal with this contingency should it arise, in order to maintain public confidence in the capacity of the system to weather economic downturns; and

(2) It is not desirable for the program's beneficiaries to act as the sole "shock absorbers" or "stabilizers" by having to absorb the brunt of economic downturns through reductions in benefit protection.

If, despite adoption of other short-term measures, the impact of a prolonged recession leaves the OASDI trust funds in a precarious position, I recommend that the trust funds be compensated for losses of revenue during periods of high unemployment. Specifically, whenever the combined OASDI trust funds fall to below 20 percent of annual outlays, a general revenue infusion equal to 0.1 percent of anticipated annual outlays should be made for each 0.1 percentage point of national unemployment in excess of 6 percent.

Backup general revenue borrowing authority/issuance of social security bonds.—In an extremely volatile economy, countercyclical general revenue infusions may be insufficient to guarantee timely benefit payments in a given year even though significantly different conditions during a period closely following might be conducive to trust fund buildup. Moreover, economic periods characterized by negative real wage growth and moderate unemployment would exert a negative impact on the program's financing which could not be addressed with countercyclical general revenues. In order to guarantee uninterrupted benefit payments even during sharp economic downturns, I recommend that the trust funds be authorized to borrow from the Treasury in the event that trust fund reserves fall below 5 percent of annual outlays. Repayments on such borrowing should begin when the trust fund levels reach 50 percent of annual outlays.

I am aware of the opposition to this proposal on the grounds that it might become a permanent, open-ended general revenue infusion. Such is not the intent of this proposal, which is offered only in the context of a Commission agreement which will finance the near-term shortfall even under the pessimistic assumptions. The intention was to come to agreement on a package substantial enough to make it unlikely that such authority would ever be used. For the sake of public confidence, however, I believe that this "failsafe" mechanism is an essential part of the social security refinancing legislation to be reported by this Committee.

An alternative form of this proposal would be to allow the trust funds to issue social security bonds directly to the public. It would be appropriate to make such bonds due during a period of large anticipated surpluses in the trust fund reserves, such as the 1990's and the first decade of the 21st century.

FUNDING OVER THE LONG RANGE

Impact of the Commission agreement

As detailed earlier in my statement, the Commission agreement solves two-thirds of the long-term problem. Under current law, the deficit is about 12.9 percent of program expenditures (that is, only 87.1 percent of benefit obligations over the long run are adequately funded). The proposals included in the Commission agreement reduce the deficit to 4.1 percent of program expenditures (payroll taxes would cover almost 96 percent of projected benefits over the 75-year period. According to the social security Actuaries, this is within close actuarial balance. Moreover, benefit obligations would be more than adequately funded over the next 50 years.

Nevertheless, I feel that there should be adequate financing in current law to cover the benefits promised to today's young workers. Before addressing this point, however, I believe it is necessary to outline how not to resolve the remaining one-third of the long-range problem.

Proposed benefit reductions

As proposals to refinance the remainder of the projected deficits are debated, it will be difficult to ignore the temptation to cut future benefits. Some may consider reducing the benefits of young workers far off in the future, the politically expedient thing to do. Others may even tout it as an "act of courage." I fail to see how reducing the incomes of the elderly and disabled constitutes "courage," simply because they are affected in the distant future.

Two major benefit reductions may be considered. The first would reduce the benefit replacement rate which determines the real level of present and future social security benefits. Under this proposal, the benefit formula "bend points" would be shifted so as to reduce the average worker's replacement rate from 42 to 37 percent. This amounts to a 10 percent reduction in the benefit obligations of OASDI. More specially, it would constitute a 10 percent average across-the-board cut in benefits.

This technical-sounding proposal reduces benefits in an insidious manner. Over time, the benefit protection of future cohorts of young workers is ratchetted down in a surreptitious manner. The result of this "bend point" reduction would be to guarantee a lower relative standard of living for future beneficiaries.

The other proposal would increase the age of entitlement for full benefits. In addition, either the age of entitlement for actuarily-reduced benefits would be raised in tandem, or the actuarial reduction would increase. This proposal is also a benefit cut.

The arguments against his proposal are compelling, overwhelming, and have been stated at length before this Committee. In sum, however, raising the "normal retirement age":

Ignores the needs of a substantial number, possibly a majority, of older workers to leave the labor force before age 65.

Uses compulsion when market forces are preferable to encourage later retirement.

Attempts to force older people to work longer but does not eliminate impediments to employment or assure jobs.

Proceeds on the assumption that because longevity is improving, health improves in tandem with longevity.

Constitutes a benefit cut.

Particularly as an 82-year-old (or young) worker, I know that this proposal should have a certain amount of attractiveness. In fact, I know many people, now working past the traditional "age of retirement" who favor this proposal. But I suspect that most of the advocates of raising the age are engaged in self-satisfying occupational pursuits which are less than physically demanding. Many workers who joined the labor force at a young age, foregoing a college education, have worked for 45 years or more by the time they reach age 62. Often, these workers are engaged in physically debilitating labor, and do not have the capacity to stay in the work force any longer. I would submit that none of these workers sit on the policy boards of groups and institutions which advocate raising the retirement age to achieve laudable-sounding policy goals.

In short, Mr. Chairman, reducing benefits for today's young workers is unwise, unfair and unnecessary. Neither of these proposals belong in this Committee's refinancing legislation. I would adamantly oppose a replacement-rate reduction or an increase in the entitlement age. There are far superior ways to finance the system's benefit obligations.

Proposed financing changes

Administrative expenses of social security.—During 1982, the OASDI trust funds will pay the general Treasury of the United States approximately $1.98 billion for the administrative costs of the OASDI program. The largest portion of this payment represents salaries, rent for properly and equipment, building operating expenses, and charges for supplies purchased. In addition, the capital costs of constructing buildings and purchasing such major items as computers and vehicles are charged to the trust funds. The OASDI Trust Funds also pay the Treasury Department for collecting contributions, issuing benefit checks, and managing fund assets; the Department of Health and Human Services for expenses related to the overall administration and planning for the system; and the states for the costs of making disability determinations.

Using the assets of the trust funds to pay for administrative costs contributes to the common perception that large portions of FICA revenues are being siphoned off for non-OASDI benefit purposes. For instance, in a 1981 Roper survey, respondents indicated that they believe that 52 percent of social security's funds are spent on administration of the program. Actually, the $1.98 billion spent in 1982 represents only 1.3 percent of the total income of the OASDI trust funds.

Even though administrative expenses represent a small proportion of total income and expenditures on an annual basis, the trust funds have transferred over $21.9 billion to the general Treasury (not including interest) for administrative costs since 1940. In addition, the long-term costs of administrative expenses will approximate .15 percent of payroll or more than 25 percent of the remaining projected long-term OASDI deficit.

As a means of strengthening the public's perception that their social security contributors are being used for the purposes they intended—i.e., benefit purposes—I would urge that (1) the administrative expenses of the OASDI program be paid from general appropriations; and (2) the trust funds be reimbursed for previous administrative expenditures. The second proposal could be enacted on a contingency basis, that is if the near-term performance of the economy is worse than anticipated.

This proposal will bring reimbursement practices with respect to the social security trust funds in line with those in effect for other Federally-administered trust funds. Currently the administrative expenses of the Highways, Airports, Federal Civil Service Retirement and Veterans' Insurance trust funds are paid from general appropriations without reimbursement from the respective trust funds. In addition, the general fund already reimburses the OASDI trust funds for the estimated expenses incurred in administering non-OASDI-related workloads. These workloads include the administration of the SSI program with its more than 4 million recipients and the processing of over 204 million annual reports of wages for the Treasury Department. During 1982, the OASDI funds will be reimbursed by approximately $920 million for these and other non-OASDI administrative workloads. Although SSA employs worksampling surveys to determine the proper reimbursement amount, it is difficult to judge whether the trust funds are being adequately compensated for those non-OASDI administrative functions. Full funding of SSA's administrative budget would assure that no trust fund monies are used to pay non-OASDI administrative costs.

The mechanics of funding OASDI's administrative expenses should not change by this proposal. Currently SSA must go before the Labor-HHS Appropriations Subcommittees of Congress to be granted annual appropriations for administrative costs even though the monies are actually derived from the trust funds. In fact, under this proposal there may be greater flexibility in providing funds for administrative improvements, such as spending $500 million for necessary upgrading of the computer systems. The annual limitation on administration expenses and the growing reluctance to use the social security trust funds for non-benefit purposes might make necessary administrative improvements more difficult to accomplish if they are financed from the assets of the trust funds.

Contingent increase in the contribution rate.—As a percent of GNP, and relative to a worker's total income, the payroll tax contributions needed to support current benefit obligations will diminish in the future. Under current law, a slightly higher payroll contribution rate would be needed if the wage base is substantially eroded, as forecasted by the social security actuaries. This projection is based on the assumptions that non-taxable fringe benefits will greatly expand, and that Congress will allow the growth of these payroll-tax loopholes.

Even if these assumptions are correct, the deficit could be entirely closed by a contingent increase in the employer/employee contribution rate beginning in the year 2010. If the above recommendation were adopted, an increase of 0.36 percent would entirely close the long-range funding gap. As a result, the OASDHI payroll tax rate would be 6.56 percent as opposed to 6.2 percent under current law (for a total OASDHI tax of 7.99 percent v. 7.65 percent under current law). If the recommendation with respect to the administrative expenses of OASDI is not adopted, the increase would be 0.46 percent.

I would reemphasize that such a contingency rate increase would not increase the burden of supporting OASDI because: Real wage levels are projected to be substantially higher by the year 2010 than at present; and although levied at a slightly higher rate, the payroll tax would be levied on a much smaller portion of total compensation than today. If the projected expansion of non-taxable fringe benefits does not occur, the contribution rate increase would be unnecessary.

Particularly because of the last reason, I strongly believe that the contribution rate increase should be made on a contingency basis. Under the Commission agreement, the program is well financed over the next 50 years and is in close actuarial balance over the next 75 years. The remaining problems some believe may occur are anticipated during the final years of the valuation period—precisely the years during which the estimates are the least reliable. We in Congress have a responsibility to approach this issue with one eye on maintaining confidence in the future of the social security system, and the other toward retaining a reasonable perspective on our ability to forecase a future three-quarters of a century away.

I have included two other alternatives to benefit reductions in order to illustrate the manageability of the remaining long-range funding gap:

Prevent erosion of taxable earnings base.—The Payroll tax is not levied on a worker's total compensation; rather, only a worker's cash wages (up to a wage-indexed annual limit) are subject to the FICA tax. "Fringe" benefits such as employee pension plans, prepaid health care, day care, parking and other in-kind compensation are exempt from the payroll tax as well as the Federal income tax. These tax incentives have spurred a substantial growth in non-payroll taxable fringe benefits: whereas 95 percent of total compensation was subject to the payroll tax in 1951, today about 84 percent is so taxable.

The intermediate II–B assumptions contained in the 1982 Trustees' Report project a straight-line continuation of this trend so that by the year 2056 only 62 percent of a worker's compensation would be in the form of cash wages and thus subject to the payroll tax. Under these assumptions, about one-third of the projected long-term deficit can be attributed to the erosion of the payroll tax base assumed to result from the growth of non-taxable fringe benefits. It appears unlikely that Congress would allow such a dramatic erosion in the tax base. This proposal would assure that such an erosion would not occur.

Under the proposal, the employers' share of the payroll tax would be applied to the total package of compensation offered to each employee (up to the taxable wage limit). At the same time, a compensating reduction in the payroll tax would be made to a level which would generate the same aggregate revenues as under current law. The change would take effect in 1990, but would use 1982 as a base in order to avoid manipulation of the taxable-to-nontaxable compensation ratio in the intervening years.

Among the advantages of this proposal is that it: Reduces the long-term actuarial deficit by 0.8 percent of payroll; retains the same real tax burden relative to total compensation; stabilizes the cost estimates by eliminating an important source of unpredictable variables in the assumptions; is neutral as an influence on the growth of fringe benefits (does not artifically increase or decrease the incentive to offer fringes); prevents erosion of tax base if substantial fringe growth occurs, thereby preventing future tax increases or benefit reductions needed to compensate such erosion; and eliminates a "paper" deficit if substantial fringe growth would not have occurred.

Restore the wage base to its original level.—Social security taxes are currently levied on about 90 percent of all earnings in covered employment. This is because all cash earnings above a wage-indexed annual limit are exempt from the tax (and also do not produce any earnings credits). This contributes to the perception of the social security tax as regressive.

Although the progressivity of the benefit formula reverses the regressive contribution mechanism, additional revenues raised through payroll tax increases do not result in higher earnings credits. As such, they substantially reduce the overall progressivity of the system. For this reason, the five Democratically-appointed Commission members recommended an offsetting income tax credit to be coupled with a payroll tax increase.

However, there are compelling reasons to increase the taxable wage base. Such an increase has the advantage of relying solely on payroll tax revenues. More importantly, no one below the taxable wage base would be affected. Raising the wage base would ensure that higher-income workers paid more of their share to finance the program. In return, these workers would receive higher wage credits, resulting in higher benefits. In addition, they would be contributing to a program which has done more to reduce reliance on means-tested public assistance than any other. The means used to finance such public assistance, the income tax, falls heaviest on the higher income workers.

Under the original Act, between 92 and 92.4 percent of earnings in covered employment were subject to the wage base. Congress allowed this proportion to dip as low as 71.5 percent in 1965, before gradually restoring the percent of wages taxable to 90 percent at present. I would recommend that, at least the original proportion of wages taxable—about 92.2 percent—be restored. This would generate $3.4 billion annually in the short run and .25 percent of payroll over the long run.[10] In combination with the payment of administrative costs, this proposal would raise .40 percent of payroll and would eliminate more than two-thirds of the deficit remaining after the Commission's recommendations. The remainder, 0.18 percent of payroll, could be eliminated by a 0.14 percent increases in the contribution rate.

I would also urge this Committee to consider raising the maximum taxable wage base so that it would include 95 percent of all covered wages. This would completely eliminate the remaining long-term deficit.

Table 6 lists four possible options for dealing with the 0.58 percent of payroll shortfall left unresolved by the Commission agreement. There are considerable variations on each of these options as well as various combinations of each. I respect the expertise and leadership shown by this Committee in the area of raising revenues, and I have confidence that this Committee will be able to finish the job that the National Commission started.

TABLE 6.—*Options for eliminating the remaining long-term deficit*

[Long-term savings as a percent of payroll]

Option 1: Contingency employer/employees contributions rate increase of 0.46 percent in 2010	+0.58
Option 2:	
Administrative costs from general revenues	+.15
Contingency employer/employee contribution rate increase of 0.36 percent in 2010	+.44
Option 3:	
Administrative costs from general revenues	+.15
Contingency employer/employee contribution rate increase of 0.14 percent in 2010	+.18
Increase wage base from 90 to 92 percent of covered earnings	+.25
Option 4: Beginning in 1990, apply payroll tax to all compensation, with offsetting tax rate reduction	+.80

A REPORT BY THE CHAIRMAN OF THE SELECT COMMITTEE ON AGING ON SOCIAL SECURITY: MYTH, MISCONCEPTION AND REALITY

INTRODUCTION

Virtually no one in America will be untouched by the consequences of the national debate on the future of the Social Security system. Social Security provides cash benefits to more than 36 million people, and more than 116 million workers are currently contributing to the system. More than 95 out of every 100 Americans are insured in the event that the earnings they depend on are lost because of retirement, disability or death.

As in any policy debate of great consequence, relevant information and data can be presented in a manner to narrow the perspective, distort the impression, and alter the conclusions of the observing general public. Some have contended that this tendency has never been more pronounced than in the debate over the future of the Social Security program.

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[10] Because of higher earnings credits, the net savings would be about 0.20 percent of payroll.

At the heart of this debate is the question of whether the level of social insurance protection offered by the Social Security program is too generous and beyond the ability of the contributing workers to adequately finance. Whether taxes should be raised or benefits should be cut and, if so, to what degree are policy matters that will be decided by the Administration, Congress, and the American people. An informed public should constitute the basis on which these decisions are made, however.

The purpose of this print is to address the common misconceptions about the Social Security system, identify the "facts" which have been presented in a manner designed to mislead or deceive, and to put the financing issue into better perspective. Some of the issues that will be examined get to the very heart of what Social Security is, and how the "original intent" of the program has been re-interpreted to support the arguments of persons or groups whose beliefs are at considerable odds with the philosophy of social insurance.

Nearly all of the misconceptions identified in this print seem to be based on three simple premises: (1) Social Security is a "bad buy"; (2) Social Security is "going bankrupt" and is headed for "an even more severe crisis" in the future; and (3) Social Security has been "altered from its original purpose." These three themes are refinements of arguments used in the past by detractors of the program, and which support a fourth premise: that Social Security must fundamentally be "reformed." This document analyzes and rebuts these myths.

That there are financing problems confronting Social Security which must be confronted is not a matter of dispute. This point has been presented in a manner disigned to oversimplify and even to sensationalize the system's financing difficulties. As a result, millions of beneficiaries have been needlessly frightened that their benefits are in jeopardy, and young workers across the nation have lost all confidence that Social Security will not continue to provide vital protection against loss of earnings into the future.

This document attempts to dispel the myths and misconceptions underlying much of the rhetoric surrounding this issue, and to place the cash-flow difficulties confronting social Security into better perspective. From this perspective, it is apparent that revenue or benefit changes needed to restore the financial health of the system are relatively modest in nature. These stand in marked contrast to many proposals which would substantially reduce benefit protection and which go beyond the magnitude required to solve the shortfall.

The format utilized in this document will consist of indentifying a common misconception and its attendant or supporting arguments. This will be followed by an analysis of and data pertaining to the issues raised or the myths perpetuated by these often-used but misunderstood arguments.

MYTH NO. 1: SOCIAL SECURITY IS "GOING BANKRUPT" BECAUSE

Misconception: Current retirees receive benefits equal to their total contributions within 18 months.—People retiring now will be fully "repaid" by social Security within 18 months. Despite this, they think they have "paid" for the benefits they receive—that they are just getting back money they put into the program. This extremely short "repayment" period is an inherent defect of the system and proves that benefits aren't really earned.

Fact: Current retirees receive benefits equal to their total payroll tax contributions approximately 1½ years after entitlement because virtually all of them entered the system before it matured. A major proportion of their working years occurred during a time when most of the workforce was not covered by Social Security. In addition, contribution rates were set at comparatively low levels because of the relatively insignificant number of persons who were eligible at the start of the program.

A dramatic expansion of the covered workforce occurred during the 1950's. Most persons becoming entitled by the end of the next decade, therefore, will have spent the majority of their years under Social Security coverage. In aggregate, their "repayment" period will be commensurate with their contributions.

Misconception: There aren't (or won't be) enough workers to support each beneficiary.—In 1950, 16.5 workers supported each beneficiary. Now that number is at just over 3. When the program was started, the number of people receiving benefits was relatively small, but we have a lot more older people nowadays. They're becoming a bigger and bigger proportion of our population.

Fact: Currently, 3 workers support each Social Security beneficiary as compared to 16.5 in 1950. Of course, before that the worker-to-beneficiary ratio was still higher—42 to 1 in 1945 and 1,000 to 1 in the early days of the system. These figures are meaningless because they compare the system at present to a time before it matured. Social Security was designed to mature by the end of the 1970's, by which time the worker-to-beneficiary ratio it was estimated, would be 3 to 1. The current 3 to 1 ratio is projected to remain in effect for at least 35 years. Future productivity gains, if only modest by historical standards, will allow continued payment of the current level of Social Security protection with little or no added burden to workers, even if the worker-to-beneficiary ratio declines.

Moreover, the total dependency ratio (the total of those below 18 and over 65 as a percentage of those between 18 and 65) has improved and will continue to improve, from its highest point in 1960 until 2010. At that time, the total dependency ratio begins to increase until it again equals the high level of 1960 by the year 2030.

Misconception: Life expectancy is increasing.—People are living much longer now than when Social Security was enacted. This means that benefit payments must be stretched over increasing periods of time, while the contribution period remains static.

Fact: Life expectancy at age 65 has increased from the early days of Social Security, but such longevity increases were always contemplated. These longevity increases have generally been surpassed by increases in productivity which have and will continue to provide an ever-increasing contribution base. Over the long run, revenues (which are tied to wages) will increase faster than outlays (which are tied to wages and prices). Incidentally, the long-term projections of the Social Security actuaries assume a trend of perpetual increases in longevity continuing, in effect, forever.[1] Such a development appears to be unlikely to occur.

Misconception: Social Security is not a "funded system".—The system is not fully funded as private pension plans and insurance policies are. In fact, Social Security has an unfunded accrued liability of $6 trillion over the next 75 years.

Fact: This concept of "unfunded accrued liability" assumes that no new workers will ever enter the system—a development which is highly unlikely to occur in a compulsory social insurance system. The statement that "Social Security is not a funded system" is intended to create the impression that the program is not actuarially sound. Social Security was never intended to be an advance-funded system; if it were, the government would be required today to hold more than $6 trillion in trust fund assets. Such an advance funded system would raise the specter of government control of industries through control of massive proportions of capital. Rather, Social Security is funded on a pay-as-you-go basis, with worker contributions and benefit payments in rough balance, and a trust fund to serve as a contingency reserve during economic downturns. The funding of outlays to future beneficiaries is guaranteed by the authority of the U.S. Government to levy payroll taxes.

Misconception: "Add-on" benefits were enacted with no way to pay for them.—Social Security has become a "Christmas tree" of benefits which has been expanded again and again. Welfare-type benefits that go beyond the "original intent" of the system have been loaded on to the program over the years. We're just now beginning to feel the effect of these deferred costs.

Fact: Spouse and survivors' insurance were added by the 1939 amendments (before the first benefits were paid), disability insurance protection was added in 1956, and hospital insurance (Medicare) was added in 1965. The present cost of the Old Age and Survivors' Insurance program (which includes spouse and survivor benefits) is almost exactly the same—9.3 percent of payroll—as it was estimated to be in 1935. Two separate taxes and trust funds were established for the Disability Insurance and Hospital Insurance programs, both of which are self-financing.

Although the cash-benefit program originally provided only retirement benefits, the additions of survivor and disability benefits simply rounded out the package of protection in a manner consistent with insurance principles. Strictly speaking, disability and survivor protection contain as many, or even more, characteristics of insurance than do the retirement benefits. Because there is a much smaller probability that disability or survivor claims will arise before age 65 than the probabilities of reaching retirement age and receiving benefits, there is more real "insurance" in these benefits than in retirement benefits.

The Social Security Administration does operate the Supplemental Security Income program for the elderly, blind and disabled poor, but funds for SSI benefits come completely from general revenues. The trust funds are not affected at all. Other programs included in the Social Security Act, like Aid to Families with Dependent Children, are administered by other agencies, not SSA.

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[1] 1982 Annual Report of the Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds, Table 11, p. 35.

Misconception: Social Security benefits are overly generous.—Benefits have actually increased at a faster rate than workers' earnings. They even overcompensate for inflation. Not only are benefit levels higher than originally contemplated, but benefit levels for workers in the future will continue to increase.

Fact: Throughout the program's history, wage increases have kept ahead of Social Security benefit adjustments. Beginning in 1974, however, the U.S. economy began a period of negative wage growth, and during the past 3 years, however, average wages increased by 30 percent while cost-of-living adjustments for those on the rolls equalled 40 percent. This was not due to any defect in the benefit formula, but rather to the protracted, unprecedented period when prices rose faster than wages. By all projections, wage increases will outstrip price increases over the long run. Moreover, even during this anomalous period of negative wage growth, total worker income increased faster than the total incomes of beneficiaries. This is because, for the most part, only the OASDI benefits of the latter group are indexed (income from other sources such as pensions and savings usually are not) while total workers' incomes increased (by definition) at the rate of national wage growth.

In real terms (that is, in terms of the proportion of pre-eligibility wages replaced by OASDI), Social Security benefits did not increase even during the past three years. Nor will Social Security benefits increase in the future, absent action by the Congress. In 1977, Congress froze the OASDI replacement rate, which ensures that benefits in the future will replace a constant percentage of preretirement or predisability wages. In fact, the ultimate replacement rates which take effect in 1982 are actually lower than those of the last nine years because of the "decoupling" of the benefit formula in 1977. However, they are roughly the same as those set by the 1939 Act.

With respect to the accuracy of the CPI, by which benefits are indexed after entitlement, SSA Studies show that the cost-of-living adjustment slightly understates the impact of inflation on OASDI benefits.[2] A specially-constructed CPI, more heavily weighted toward expenditures which predominate in an aged person's budget (such as medical care and food at home) and less heavily weighted for expenditures such as mortgage interest and transportation, yields an inflation pattern which, over time (1977-1981), slightly exceeds that of the CPI.

Misconception: The trust funds will run out in 1984.—The trust fund reserves have sharply diminished because the system has "lived beyond its means." They are now losing $17,000 a minute, and the "greatest bankruptcy in history" will occur in 1984 when the trust funds are depleted. During the next century, we face a much greater crisis.

Fact: The financing picture is not nearly as bleak as implied by these statements. The poor performance of the economy during the last few years has created short-run cash flow problems in the Social Security system, in the same way it has created havoc in every other sector of the national economy from agriculture to housing to the financial industry. As a result, the contributions scheduled over the next 8 years will be approximately 3 percent short of the amount required to make complete benefit payments on time. Even if the trust funds were allowed to completely exhaust themselves, current tax contributions would support about 97 percent of promised benefits.

Every percentage point of increased unemployment costs the system some $2 billion a year in uncollected revenues; every percentage point increase in the Consumer Price Index costs the system $1.6 billion in benefits to sustain purchasing power of beneficiaries. Higher than expected levels of both inflation and unemployment have taken their toll on the system. Nonetheless, the adjustments needed to ensure that the trust funds remain solvent through this decade are not as dramatic as is commonly perceived.

During the 1990's, however, massive surpluses will begin to accumulate in the OASI and DI trust funds which will remain intact for another 25 to 35 years. Even if the unduly pessimistic assumptions of a low-growth economy, artificially low immigration rates, and dramatic growth in fringe benefits not subject to FICA tax come true, the projected 75-year deficit in Social Security amounts to no more than 12 percent of expenditures. In terms of the amount of revenue required to eliminate this hypothetical deficit, a 1 percent increase on the employer and employee payroll tax effective in 1990 would bring the system into balance over the 75-year period.

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[2] Social Security Bulletin, January 1981.

TABLE 1.—*Short-run projections for Old Age, Survivors and Disability Insurance trust funds* [1]

[Dollars in billions]

Trust fund at beginning of 1983	$18.4
Payroll tax contributions, 1983–91	$2,226.6
Benefit payments, 1983–91	$2,269.3
Net increase in trust funds, 1983–91	−$42.7
Additional revenue required,[2] 1983–91	$61.0
Shortfall as percent of benefit, 1983–91	2.68

[1] Under Trustees' Intermediate H–B economic assumptions.

[2] Amount of tax revenue required to continue timely payment of benefits. Smaller or larger amounts would be required to the extent that economic conditions were better or more adverse than those projected under the H–B assumptions.

MYTH NO. 2: "SOCIAL SECURITY IS A 'BAD BUY'" BECAUSE

Misconception: You receive much less than "what you paid in".—Social Security is a poor buy because individuals can purchase much larger benefits in the private sector.

Fact: Many analyses which suggest this utilize sets of assumptions which are internally inconsistent. Characteristically, such studies assume a permanent rate of return (interest rate) on contributions which is relatively high (such as 10 percent) but assume a very low CPI increase (such as 3 percent) or ignore CPI increases altogether. These analyses typically consider what is actually purchasable in the private sector for the combined employer-employee tax, although the employer tax or even the employer's per capital cost is not equally assignable to each employee.

This misconception also stems from the failure to account for the value of Social Security's family insurance, survivor insurance and disability insurance benefits. Social Security protects not only a worker but also his spouse, children and parents in the event of disability, retirement or death. Protection under Social Security is completely portable throughout the entire workforce,[3] and comes into effect at precisely the time during which the capacity to contribute to private annuities ceases. The basis benefits paid at the time of entitlement completely reflect increases in the standard of living which occurred during a contributor's working lifetime. Social Security benefits are tax-free and guaranteed inflation-proof.

By contrast, private plans only cover about 50 percent of the working population, only about half of whom will become "vested" in (or obtain a nonforfeitable right to) their pension. In addition to the serious problems associated with lack of coverage, vesting and portability, most pension benefits are relatively insignificant because earnings credits are not updated for wage growth, and the benefits upon retirement typically have little, if any, inflation protection. In short, no private plan can match the package of protection offered by Social Security.

Misconception: Young workers won't receive an adequate return on their contribution.—Future workers will receive an ever-diminishing level of benefit in return for their excessively high payroll tax contributions.

Fact: Workers retiring 10, 20, 30 or even 75 years from now will have the very same proportion of their earnings replaced by Social Security as current retirees. While it is true that the contribution rate will be slightly higher in 10 years than it is now (7.65 percent vs. 6.70 percent), real wage levels historically have been rising constantly.

The most recent (1979) Social Security Advisory Council studies show that even the highest paid, youngest new entrants into the Social Security system will receive their money's worth when all benefit provisions and demographic probabilities are taken into account.

Tables follow:

TABLE 2.—*Benefit/tax ratios for hypothetical workers and couples entering covered employment at age 22 in 1979*

Worker or couple	*Benefit tax ratio*
Never married male worker, maximum earner	
Married male worker with nonworking wife and 2 children, maximum earner	

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[3] With the exception of Federal civil service, some State and local government employment, and some private, nonprofit institutions.

Worker or couple	Benefit tax ratio
Never married female worker, maximum earner	1.32
Couple, 2 maximum earners	[1] 1.25
Couple, male maximum earner, female median earner	[1] 1.63
Never married male, average earner	1.52
Married male worker with dependents, average earner	3.48
Never married male worker, minimum wager earner	1.89
Married male worker with dependents, minimum wage worker	4.28

[1] Ratio is for the couple, not the individuals.

Source: The figures update those given in Orlo Nichols and Richard G. Schreitmueller, Some Comparisons of the Value of a Worker's Social Security Taxes and Benefits. Social Security Administration Actuarial Note No. 95, April 1978. The methods and concepts are the same.

TABLE 3.—*Benefit tax ratios for hypothetical workers retiring at age 65 in 1979*

Worker	Benefit tax ratio
Single male, maximum earner	4.97
Single male, average earner	5.51
Single male, low earner	7.07
Single female, maximum earner	6.21
Single female, average earner	6.88
Single female, low earner	8.82
Married male worker with dependent spouse, maximum earner	9.19
Married male worker with dependent spouse, average earner	10.18
Married male worker with dependent spouse, low earner	13.06

Source: Unpublished estimates based on calculations by the Office of the Actuary, Social Security Administration. The methods and concepts are the same as those underlying table 2. The ratio is computed using only OASI employee contributions.

New entrants into the workforce (table 3) will not enjoy the same rate of return as current beneficiaries (table 2). In general, the latter group made payroll contributions during a portion of their working lifetimes at considerably lower tax rates than those presently in effect for current workers. This is attributable to the relatively smaller proportion of beneficiaries in the program at its inception. Benefit/tax ratios will indeed decline over the next period of years, but not indefinitely. As the Social Security system *matures* and America itself grows older, those ratios will stabilize at positive rates.

Misconception: Too much of the contributions are funnelled away on administrative costs.—The administrative costs of operating the Social Security system are so high that the benefits provided are a poor buy.

Fact: The administrative costs of the Old Age, Survivors, and Disability Insurance program represent 1.3 percent of the benefit payments. Total costs for administering the hospital insurance program are proportionately slightly higher—about 1.6 percent of benefits. These costs are substantially lower than all but the very largest group insurance operations. Because the administrative expenses of the program are so low, virtually all of the taxes collected are, or will be, returned to contributors as benefit payments.

MYTH NO. 3: "SOCIAL SECURITY HAS BEEN ALTERED FROM ITS 'ORIGINAL PURPOSE'"

Misconception: Contributions were supposed to guarantee a retirement annuity.—Social Security was set up as a retirement program where the individual annuity would be based on each person's contributions. A worker's taxes would be deposited in an account to collect interest until a worker became eligible for benefits.

Fact: Social Security was never structured along the lines of pension or annuity plan; income from these sources was to add on to the base provided by Social Security. The Old age and survivors' Insurance program was conceived along the lines of a nationwide system of social insurance which involved pooling of risks to provide benefits. Although Disability Insurance was enacted later, benefits are paid according to the same principle.

Because benefits are based on an insurance principle rather than a pension principle, benefits are not exclusively determined by contributions—as in a savings account, for example. The contributions themselves are used to finance benefits to persons already on the rolls; benefits of future retired and disabled workers will be paid by future contributing workers.

Misconception: "People don't get out what they paid in".—Even discounting for the fact that a current worker's actual contributions are used to pay for benefits to people now on the rolls, a retiree's benefits bear no relation to his past contributions. Some receive much more than they ever contributed; others receive little or nothing.

Fact: Actually, one of the two chief determinants of the benefit level is that beneficiary's past contributions. A worker's primary insurance amount (the benefits for the individual and for all dependent and surviving family members are based on this) is based on his or her average wages. There is some weighting in the benefit formula in favor of lower-income workers. In general, however, the more one contributes, the higher one's benefits are.

The other determinant is whether or not a worker loses earnings because of retirement, disability or death. Because Social Security insures a worker's earnings against these risks, payment of benefits is tied to whether or not they occur. Of course, a higher-earnings worker is insuring a greater amount of income against loss, so he or she would receive a higher benefit than a low-income worker in the event that they both retired, became disabled, or died at the same time. Generally, however, workers do not receive benefits until retirement, disability or death.[4]

It is possible for a lower-income worker to become disabled or retire much earlier than a higher-income worker, and therefore receive greater total lifetime benefits. It might appear that he is receiving a "greater return on his contributions" than his counterpart. Both workers, however, are contributing in order to build up protection against loss of income, rather than to build up a retirement annuity. This level of protection is tied to a worker's contributions, and will always increase when a worker's wages and contributions increase.

Just as a homeowner's policy insures one's home against the risk of fire, floods or theft, social insurance insures one's earnings against the risk of retirement, disability or death. Families insuring homes of differing values pay different premiums for different levels of coverage. Thus the family insuring a $100,000 home will pay a smaller premium than its neighbors with a $200,000 policy. In the event that both families lose their homes in the same fire, each would receive benefits that reflect the premiums paid.

So it is with Social Security: A worker with average lifetime earnings of $20,000 will pay twice as much in payroll contributions as a worker with earnings of $10,000. In the event that they lose their earnings (retire) at the same time, the first worker will receive a much larger benefit than the second.[5] That is the individual equity principle of Social Security—"you get out what you put in."

But there the similarity with a pension ends. A pension plan cannot adapt itself to many contingencies beyond retirement at a set age, such as disability, illness or death. Social insurance can. To go back to the example, one of the homeowners may never file an insurance claim during his lifetime, while the other may file multiple claims because of fire, flood, theft, etc. The first homeowner would not, under the definition of a pension plan, "get out what he paid in," while his neighbor would receive far more than the combined total of paid premiums. That is the social adequancy principle of Social Security.

In each instance, the policy provides a level of protection that far exceeds the value of aggregate premiums. If each homeowner had instead deposited an amount equal to the insurance premium into a fixed return investment, such as a savings account, the return would be insufficient to replace the value of a lost home. For this reason, the framers of the Social Security Act used the social insurance concept rather than enacting a national pension plan.

Misconception: Refugees, aliens and others who didn't pay in receive benefits.—The trust funds have been "robbed" in order to pay welfare benefits to refugees and aliens. This may serve a humanitarian purpose, but the money should come from the general fund, not the Social Security trust funds.

Fact: It does. By law, the money in the Old Age and Survivors Insurance, Disability Insurance, Hospital Insurance, and Supplementary Medical Insurance[6] trust funds, as well as "FICA" tax revenues collected under the Federal Insurance Contribution Act can only be used to pay for old age, survivors' and disability insurance benefits, reimbursement under Medicare, and the administrative expenses of these programs. In general, no one receives benefits without a minimum level of contributions—and benefits are tied to the level of contributions (the exceptions are listed below).

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[4] At age 72, all fully insured persons receive benefits even if earnings are not lost because of retirement.

[5] Though it would not be twice as much, because benefits are "weighted" to replace the earnings of lower-wage workers at a higher rate.

[6] The SMI, or Medicare part B trust fund, is financed out of general revenues and beneficiary contributions.

The supplemental security income program pays a poverty-level benefit to very poor persons who qualify because of their age (65 and over), disability, or blindness. SSI benefits are extremely low and subject to strict asset tests. The Social Security Administration is responsible for administering the program, but the benefits are financed by the general tax revenues, not the Social Security trust funds.

Because Social Security benefits are paid as a matter of right earned by fulfilling certain contribution requirements, there are no citizenship or permanent residence requirements for receiving them. However, illegal alien workers earning Social Security coverage will decrease in the future as a result of stricter regulations for obtaining Social Security numbers promulgated in 1978. Moreover, studies by the U.S. Select Commission on Immigration and Refugee Policy and the TransCentury Foundation found that illegal aliens contribute significantly more to Social Security than they receive in benefits. This is because (1) many illegal aliens are young, work here for a while and pay Social Security taxes, but do not work long enough to become eligible for benefits; and (2) many who become eligible do not claim benefits because of fear of dealing with a government agency.

Misconception: Wives, widows and disabled people who have never paid in receive benefits.—Social Security is paying benefits to a much larger group of people than the group which actually contributed. Out of 36 million drawing benefits, only 20 million are retirees who actually paid in.

Fact: Social Security offers one feature which no other private plan can match: complete family protection. Benefit protection is predicated on an assumption that the loss of income to a primary worker is felt, to varying degrees, by other dependent family members. For example, the spouse of a retired worker receives 50 percent of the retired worker's benefit, in recognition of the spouse's contribution to the family's well-being.

A spouse, a dependent or disabled child, a parent in the care of dependent children, and a surviving spouse or child, all are eligible for benefits on the record of a fully insured retired or deceased worker. The benefits they receive are tied to the contributions of the primary worker, and they are actuarily calculated to reflect that contribution level. In other words, the contribution rate for workers is computed to reflect the cost of providing family protection for a worker's dependents and survivors. It is also worth noting that many persons receiving benefits as spouses or survivors made payroll tax contributions in their own right.

It is simply not true, moreover, that disabled workers "did not contribute" toward their benefits. To be eligible for disability insurance benefits, a worker must have at least 1 quarter of coverage for each year since the worker reached age 21 and have minimum covered earnings in 20 of the last 40 quarters of covered employment. Moreover, Social Security's definition of disability is one of the strictest of any social insurance program in the western world.

Disability insurance does not constitute a "drain" on the retirement trust fund. There is a separate and distinct Disability Insurance trust fund into which flows contributions generated by a separate and distinct payroll tax. Benefits paid to disabled workers and their dependents and survivors are tied to payroll tax contributions. As part of the sharing and pooling of risks principle of social insurance, only a relatively few collect Disability Insurance benefits, but all insured workers (currently 93 million) receive protection.

Moreover, the Disability Insurance trust fund is substantially overfinanced in both the short term and the long term. There is no year during which system outlays are projected to equal or exceed income under even the most pessimistic set of assumptions. As a result, the DI trust funds will continue a steady buildup of reserves, to the point where fund assets are projected to range from 2000 percent (pessimistic assumptions) to 5,500 percent (optimistic) of annual outlays by the year 2060.

Misconception: Taxes have increased dramatically in order to pay for dramatic benefit increases.—The original Social Security Act provided for a 1 percent tax on employer and employee on the first $3,000 of income. The original law never contemplated the dramatic increases in the payroll tax or to the wages on which the tax is applied.

Fact: Actually, the 1 percent tax rate was set by the original law only for 1937–1939, after which it would increase gradually until it reached 3 percent in 1949. It was also anticipated that the cost of the Old Age and Survivors' Insurance program would reach 9.3 percent of payroll. And, in fact, the cost of the program is 9.4 percent of payroll (this cost is shared by employers and employees).

The original estimates of the relative amount of wages subject to the payroll tax were also amazingly close to what actually developed. In the late 1930's, the $3,000 maximum taxable earnings base represented 92 percent of all earnings in covered employment. While the 1982 figure of $32,400 appears to be a substantial increase, this amount represents just 89 percent of all earnings in covered employment.

Finally, benefits currently replace roughly the same percentage of a worker's preretirement wages as they did under the original act.

Misconception: The trust funds have been used to finance various wars, foreign aid, the moon race.—Presidents Roosevelt, Truman, Eisenhower and Johnson have "misused" the Social Security trust funds by allowing them to be used to finance a myraid of government activities.

Fact: As stated previously, the assets of the trust funds can be liquidated only for purposes of benefit payments (97.3 percent of disbursements) and to pay administrative costs (1.3 percent of disbursements).[7]

Confusion has arisen because of misrepresentation about the investment of the trust fund assest in U.S. Government securities. Through the investment of such assets in U.S. Government securities, additional money is made available to the general fund. However, as is the case with the purchase of government securities by a private individual, the investment of Social Security trust fund assets in U.S. Government securities creates an obligation on the part of the U.S. Government.

The Social Security trust funds are owed the principal amount of the orignal investment in addition to a specified rate of interest. The U.S. Government has never failed to meet its Social Security trust fund obligations. That the government uses the money it borrows for purposes such as defense or foreign aid in no way diminishes the obligation it has created to pay it back when due.

Concerns have also been raised with respect to the investment policies followed by the Social Security board of trustees. These concerns apply to the alleged failure of the board of trustees to secure the greatest possible return on the trust funds, rather then any "misuse" of funds.

In 1981, the OASDI trust fund reserves yielded an average of 8.8 percent with some long-term obligations earning as little as 3 percent. Although recent trust fund purchases have had more favorable yields (about 13 percent), the Treasury Department's standard investment and redemption practices have limited the yields which the trust funds could have received.

If during, 1960 to 1980 the special issues ending lower rates were reinvested at the higher rates paid on new special issues each June, the Treasury Department estimates that an additional $13.5 billion would have accrued to the OASDI trust funds. This could have raised total interest income for the period by 47.5 percent (form $28.4 billion to $41.9 billion). Some have suggested, however, that this practice would give an unfair advantage to the trust funds at the expense of the overall general fund.

MYTH NO. 4 SOCIAL SECURITY CAN BE "REFORMED" WITHOUT ADVERSELY AFFECTING BENEFICIARIES BY

Misconception: Slowing the growth in benefits.—No one really wants to "cut" Social Security benefits. But if the program is to be brought under control, benefits to future recipients cannot be allowed to increase at their present rate.

Fact: This is one of the most common misconceptions about Social Security. Social Security benefits are traditionally measured in terms of "replacement rates"—that is, how much of a beneficiary's pre-retirement or pre-disability earnings are "replaced" by the Social Security benefits. The fact is, these replacement rates will not increase in the future. Purchasing power of initial benefits may rise or fall in the future, depending on the relationship between wages and consumer prices, but the share of pre-retirement earnings provided by Social Security benefits is fixed. A constant replacement rate of 42 percent for an average-wage worker was locked into the law in 1977 and will remain in effect in perpetuity unless changed by an act of Congress. This means that an average income worker will have 42 percent of his lifetime average woages replaced by Social Security, whether he or she retires (or becomes disabled) in 1982, 2002 or 2052. Replacement rates of 53 percent and 29 percent are in effect for minimum-wage and maximum covered earnings workers, respectively. These rates are also locked in by the 1977 law.

Measured in terms of wage replacement, in fact, benefit levels have actually declined over the last few years. This is another result of the 1977 amendments, which corrected a flow in the previous law that resulted in overindexed benefits. People becoming entitled in 1982 and beyond will receive benefits which are about 7 percent lower, relative to wages, than their immediate predecessors.

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[7] About 1.4 percent of disbursements are used for obligations under the program's interchange with the Railroad Retirement program.

If, as everyone hopes and aniticpates, real wages increase in the future, present law could indeed yield benefits that provide greater purchasing power. Nonetheless, advocating "slowing the growth in future benefits" by lowering replacement rates is simply another way of advocating that future retirees take a sharper reduction in income when they retire than is the case today. Between December 1980 and December 1981, for example, the average Social Security benefit awarded to a retired worker climbed from $360 to $396. Although the actual dollar amount was higher, the replacement rate was constant. In fact, the actual dollar amount of benefits awarded declined to $382 by March 1982. This occurred because the ultimate replacment rates of 42 percent came into effect this year.

It is possible for the actual dollar amounts of benefits to those in the future to rise, even as they mean less in terms of wage replacement or even purchasing power. If only actual dollar amounts—or even price-adjusted dollar amounts—are considered, it is possible to claim or oppose "cuts in benefits" while advocating substantial reductions in benefit protection.

Misconception: Enacting modest benefit reforms as opposed to massive tax increases.—Saving the system would require dramatically increasing the tax burden on young workers. In the long run, tax rates would have to be two or three times what they are now in order to support benefits already promised. Not only would young workers oppose such tax increases, but modest and gradual benefit reforms would be a small price to pay for bolstering the program's solvency and reducing people's fears and anxieties.

Fact: Whether the system's cash flow shortfall should be addressed by raising revenues, reducing benefits or a combination of benefits is a public policy question to be considered by the Congress. Yet the size of the shortfall remains the same, whether benefit cuts or tax increases are used to address it. To suggest that the choice is between "major" or "dramatic" revenue measures and "modest" or "gradual" beneft reforms is to stretch common sense to its limits; i.e. the solution must equal the shortfall.

In fact, it can be argued that the reverse—that only "modest" revenue increases would substitute for "major" benefit cuts—is true. There are 116 million contributors to, and 36 million beneficiaries of, Social Security. Mathematically speaking, the impact of a benefit reduction on a beneficiary is three times as great as the impact of a tax increase on a [illegible] if both measures yielded the same amount of savings. Assuming that Con[illegible]shed to distribute the impact of financing changes equally among wor[illegible]neficiaries on a per capita basis--and there is no indication Congres[illegible]ports such a distribution—three times as much of the savings woul[illegible]ome [illegible]enue measures as from benefit reductions.

When the entire package of [illegible]urity protection is considered, polls show, most workers do not consider [illegible]ax contributions to be burdensome.[8] In fact, a majority of workers sup[illegible]x increases if needed to retain the current level of benefit protectio[illegible]eater majority (more than 2 to 1) prefer general revenue financi[illegible] to [illegible]eductions as a way of meeting the shortfall. They understand that [illegible] need not only to solve the system's financing problems to protect today's beneficiaries, but also to assure their own prospective benefits are not needlessly slashed.

If Congress had no other options before it, a payroll tax increase of 1 percent between now and 1990 would be required to meet the near-term shortfall. If long run projections come to pass, an additional payroll tax increase of 1 percent beyond 1990 and through the next century would be needed to support promised benefits. An increase from 6.2 percent to 7.2 percent would not be insignificant, but would not amount to a two-fold or three-fold increase from today's 5.35 percent.

Misconception: Expanding individual savings and pension plans.—People should rely more on income from private pensions and individual savings in their retirement years. Income from these sources could "take up the slack" if Social Security benefits were cut.

Fact: Ideally, employee pension plans, individual savings and Social Security should constitute the three principal tiers of income maintenance for those who lose their earnings capacity. Unfortunately, only the Social Security system—with its virtually universal coverage, total portability, updating of earnings credits, family protection and complete inflation protection features—is fulfilling its role.

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[8] Peter D. Hart poll conducted for the National Commission on Social Security, released March 1981. Louis Harris poll released November 1981.

Private pension coverage extends to only 50 percent of the working population, and only half of these—or 25 percent of the workforce—will ever earn a nonforfeitable right to their benefits. (The other half do not remain with an employer long enough to become "vested" in their benefits.) Numerous other problems involving poor family protection, virtually nonexistent inflation protection, inadequacy of pension benefits and concentration of coverage among upper-income workers are characteristic of the private pension system. Individual savings shows some promise as an added supplement, since tax-deferred individual retirement accounts are free of problems such as pension forfeitures and lack of pension portability which plague the employee benefit system. However, the vast majority of retirement savings are concentrated within the higher-income strata of workers.

While expansion of the savings and pension sectors as supplements to Social Security would address many of the income adequacy concerns of future generations of retirees, these two income sources are not substitutes for social insurance protection. They are predicated on assumptions of a constant, life-long wage earning history and that a substantial portion of those wages will be available for retirement savings contributions. If wage-earning is interrupted because of disability or unemployment, or if earnings levels are too low to allow for substantial savings, the eventual benefits from these sources are insignificant. Social Security is designed to cover these contingencies, to which the entire working population is at risk.

Mr. **Pepper**. I can assure you, Mr. Chairman, as you always do, you certainly always will as long as I am chairman, reserve a most cordial welcome when you come before the Rules Committee and we shall view your appearance on this matter with particularly sympathetic interest.

Mr. Chairman and members of this distinguished committee, I am very grateful for the privilege of appearing before you today. We are engaged in an historic process in this country. It is comparable almost to the response of our people to the challenge of war. We have seen a president of one party and a speaker of another party and leadership in both parties joining hands to meet and solve a national emergency. This emergency concerns one of the most meaningful and successful programs in existence serving the people of this country.

Mr. Chairman, if I may, I would like to presume that I may appear here this morning in a dual capacity. One, as a member of the Social Security Commission appointed by the gracious hand of the Speaker, and second, if I may presume to do so, to speak for what I believe to be for the best interest of the elderly people of America.

I am one of those people myself, being 82 years of age and for the last 6 years I have had the honor to be chairman of the House Select Committee on the Aged. I hope by the appointment of the Speaker I shall retain my membership on that committee and my chairmanship of the Health Subcommittee of that great committee.

Today we are engaged in a most important matter and I am pleased to see the fine spirit of cooperation that emanates from this distinguished committee as it approaches this very momentous question. Social security I consider the third most important contribution the Government of the United States makes to its people. Of course, the Government's first and greatest contribution is keeping our country free of any foreign invader.

Second, the Government makes it possible for us to live as free men and women in a free society. Finally, the Government makes it possible for the people of this country to enjoy economic security in the event that earnings are lost because of retirement, disability or death. The mechanism through which this is done is the social security system. About $1⅓ trillion has been taken in by social security and thereafter disbursed by the Government of the United States since social security began collecting payroll contributions in 1935. The first check was actually mailed in 1939.

I came to the Senate November 4, 1936. So except for the 12 years I was out of the Congress between 1951 and 1963 I have been in the Congress during the lifetime of social security. I have had a chance to see the working and the meaning of that great system as a Member of the Congress of the United States.

It was the Roosevelt administration that initiated social security with all of its meaningful import to the people of the country. Today, 36 million people receive a check every month under social security. One half of those people, according to the Congressional Budget Office, would be on welfare if it were not for social security. Nearly a third of those recipients have no other source of income, and 6 out of 10 recipients of social security rely primarily upon social security for their sustenance.

So you can see how meaningful social security is. The average check of social security is $400, not exceedingly generous, but perhaps the only barrier between millions of recipients and abject poverty. It is not difficult to see what is involved in this hearing in which you are engaged today. I am here not to simply discuss the question of what we are paying but to examine what we are getting and to compare what we are paying with what we are receiving as prospective recipients of social security under the program that this package makes possible.

Now, Mr. Chairman, all of the members of this distinguished committee will recall what the situation was prior to the appointment of the Commission by the President and by the Senate and House. At that time we remember the President had addressed the Congress with appeals to make sharp reductions in social security benefits over the following 5 years.

The people and the Congress rejected those appeals by the President and then the President resorted to the course of appointing a Social Security Commission comprised of 15 members—five named by the majority leader of the Senate, the Honorable Howard Baker; five named by the Speaker of the House, the Honorable Thomas P. O'Neill; and five named by the President himself.

Mr. Chairman, if I may, I ask unanimous consent that the names and the descriptions of the status of the members of the Commission appear in the record at this point in my remarks.

[The information follows:]

SUPPLEMENTAL REPORT—MEMBERS OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

APPOINTED BY THE PRESIDENT

Alan Greenspan, Chairman: Chairman and President, Townsend-Greenspan and Company, New York, N.Y.

Robert A. Beck: Chairman of the Board and Chief Executive Officer, Prudential Insurance Company of America, Newark, N.J.

Mary Falvey Fuller: Management Consultant, San Francisco, CA (Member of 1979 Advisory Council on Social Security).

Alexander B. Trowbridge: President, National Association of Manufacturers, Washington, D.C.

Joe D. Waggonner, Jr.: Consultant, Bossier Bank and Trust Company, Bossier City, LA (Member of Congress from Louisiana in 87th and 95th Congresses).

APPOINTED BY THE MAJORITY LEADER OF THE SENATE, IN CONSULTATION WITH MINORITY LEADER

William Armstrong: Senator from Colorado and Chairman of Subcommittee on Social Security, Committee on Finance.

Robert Dole: Senator from Kansas and Chairman of Committee on Finance.

John Heinz: Senator from Pennsylvania and Chairman of Special Committee on Aging.

Lane Kirkland: President, American Federation of Labor—Congress of Industrial Organizations.

Daniel Patrick Moynihan: Senator from New York and Ranking Minority Member of Subcommittee on Social Security, Committee on Finance.

APPOINTED BY THE SPEAKER OF THE HOUSE OF REPRESENTATIVES, IN CONSULTATION WITH THE MINORITY LEADER

William Archer: Representative from Texas and Ranking Minority Member, Subcommittee on Social Security, Committee on Ways and Means.

Robert M. Ball: Visiting Scholar, Center for the Study of Social Policy, Washington, D.C. (Commissioner of Social Security, 1962–73).

Barber Conable: Representative from New York and Ranking Minority Member, Committee on Ways and Means.

Martha E. Keys: Director of Educational Programs, The Association of Former Members of Congress, Washington, D.C. (Member of Congress from Kansas, in 94th and 95th Congresses, and Assistant Secretary of Health and Human Services, 1980–81).

Claude D. Pepper: Representative from Florida and Chairman of Committee on Rules.

Mr. PEPPER. That was a Commission of 15 outstanding Americans, leaving the present company out of inclusion. On the Commission were outstanding businessmen; the head of the largest insurance company in the United States, head of Prudential Insurance Co., Mr. Robert Beck. There was Mr. Trowbridge, a former Democratic Cabinet member under the Johnson administration, president of the National Association of Manufacturers.

We had the chairman of the Finance Committee of the Senate, the Honorable Robert Dole, the chairman and ranking Democratic member of the Social Security Subcommittee in the Senate the Honorable William Armstrong and the Honorable Daniel Patrick Moynihan. From this body the ranking Republican of this committee, the distinguished gentleman from New York, the Honorable Barber Conable served on the Commission. We had also the distinguished gentleman from Texas who is the ranking minority member of the Subcommittee on Social Security of this distinguished committee.

We had Mr. Lane Kirkland, president of the American Federation of Labor. There were two former members of this distinguished committee, Mr. Joe Waggonner and Mrs. Martha Keys. We had the man who three times was the Social Security Commissioner under three Presidents, Mr. Robert Ball. I consider him one of the most knowledgeable men in the subject of social security in our country. Finally, the Honorable John Heinz, distinguished Senator from Pennsylvania, chairman of the Senate Committee on Aging as I have been in the House, served on the Commission.

But at the same time it was a group of people with a variety of views. In general, those five of us in the committee who were appointed by the Democratic Party first gravitated together, began to work together and did work together throughout the deliberations of the Commission. Our stance was to raise the requisite revenues to finance benefits promised under the law.

The sentiment prevailing among the other members was "cut benefits"; that the way to solve the social security shortage was to cut benefits—reduce the outgo to the level of the income and then you would have the problem with social security solved.

It just happened that last year I had the honor of appearing in 26 States in behalf of Democratic candidates for the Congress and in every place I spoke for a Senator or representative-to-be, I held up that candidate's hand before a crowd of people, elderly people primarily, and I said so-and-so "promises you as I do he will not vote to cut social security benefits." And I have pledged that to the people of this country all over America and so I could not, under any circumstances, vote to cut their benefits. I thought there were other solutions because the social security benefit structure is hardly extravagant as it is. The average is $400 a month. That's barely above the U.S. Government's official poverty level.

I hope to see the day when this great committee will find it proper and possible to expand the benefits that we now have. But at least we don't want to reduce the current level of benefit protection to which the people of this country are accustomed. Advancing this position were five Democratically appointed Members who worked together on the panel, including Martha Keys, Lane Kirkland, Senator Moynihan, Robert Ball, and myself. We held fast to the principal that we could not support reductions in social security benefits. On the other hand, there was an equally strong opinion on behalf of many of the members of the Commission that we must cut benefits as a part of arriving at a stable basis for social security. Finally, others advocated a combination of adding new revenue and reducing outgo, but that the only way to do the latter is to cut benefits.

The President had announced to the country that he would not support any use of Federal income to solve the problem with social security nor would he support any new taxes for that purpose. There he was, the President of the United States with that announcement of policy and prohibition on his part. And so that was our dilemma, how to find the solution to this problem. What was the honorable, what was the right thing to do.

We were appointed in December 1981. We arrived at our decision about 7:30 p.m. Saturday, January 15, 1983. Now we were a group of 15 people. We had most excellent staff; Mr. Robert Myers here was the Executive Director. In addition, we had Mr. Ball, one of the most knowledgeable men on social security in the United States. He was its Commissioner. We had additional able staff people advising us and yet it took us over 12 months for that Commission to finally to come to a consensus that we could offer as a package to your distinguished committee.

As a member of the Commission who agreed to the package, I am asked "Do you approve of all these things that are in there? You say you are a friend of the elderly? Do you mean to say you approve of denying the elderly their cost of living adjustment, what we call the COLA, for 6 months of this year from July 1 to January 1 of next year? Well, you must not be a very good friend of the elderly." No, I don't approve of that particular provision. But the COLA delay is part of a package, a package that I can approve of. And the question we have to decide is whether it is better to make a concession that is a relatively small one for a much larger reward, or sit stubbornly by like a knot on a log and do nothing and let this great house collapse around us.

I ask your distinguished committee, Mr. Chairman, what if your committee were put to the responsibility that we have? With only 15 people meeting outside the pressures that we have here in the Congress. It took 1 year to come together with a package. We have got to do something by May of this year.

Suppose we did not have this package. I called the White House three times on Thursday and Friday before we came to the final consensus Saturday evening, urging, pleading with the top representatives of the President that from the President's point of view he can't afford not to go along with this package if the Speaker will go along. For his part, the Speaker had indicated that he was willing to be flexible and cooperative and would go along with what we recommended.

And so finally came the time on Saturday. Even on Saturday morning we had not solved the problem, the 15th of January. That was the last day of the life of the Commission.

I went over to the White House about 5:30 on Saturday afternoon. Mr. Baker, Chief of Staff and his associates went to and from Blair House to the White House two or three times before we finally came to a conclusion, before the Speaker issued his statement and the President issued his statement of concurrence in this package.

And everybody did it out of a sense of what was good for America. I hope we can say at least for the others I can say they showed themselves good Americans above the partisanship that naturally divided us on these political issues, And so we present to your honorable committee this package.

So my conclusion is this; yes, we don't like to delay the cost-of-living adjustment for 6 months. How much would it be if one received the average social security check? For the average benefit of $400 a month, assuming 5 percent inflation the reduction would be $20 a month, and for 6 months it would be $120. This would be what the average person getting social security benefits would lose for one time due to the delay in the adjustment from July 1983 to January 1984. That is one time that loss occurs.

What other losses could be inflicted upon the recipients of social security? For some higher income recipients, their benefits would be included in their adjusted gross income. This is how it would work. If you are a recipient of social security, you get a social security check and you would be subject to the same laws with respect to taxation liability that you are subject to if you receive unemployment compensation or you are a civil service retiree, except that half of the benefit derived from the employer contribution, which is not taxed, would be subject to the income tax. Specifically, if you are a single person and you make more than $20,000 a year other than your social security benefits, then you will have to pay your ordinary income tax on 50 percent, not 100 percent, only 50 percent of your social security benefits.

That will affect about 11 percent of the recipients of social security. Of course, they would rather not do it. I would very much have preferred in the beginning that the Government of the United States help social security weather the impact of the poor performance of the economy.

The Reform Commission was the title of our Commission. Social security doesn't need to be reformed. It is the economy of this country that needs to be reformed. It was primarily the highest sustained level of unemployment that caused the prices that we have today.

In addition, there was an exception in the behavior of prices in relation to wages which made prices rise since 1974 higher than wages rose. Combined with the record levels of unemployment, this negative wage growth depleted the assets of the trust funds faster than they could be replenished. As a result, we have a cash-flow problem. For the rest of the decade, incoming contributions may only be enough to cover 95 or 98 percent of benefit payments.

I would have much preferred that we take account of the assurance given to us by the social security actuaries and Mr. Robert Ball that by 1990 large surpluses in the old-age and survivors insurance fund will begin to build up. From that surplus we could have paid back any money we borrowed from the Treasury in the interim of 6 years, from 1983 to 1989. I would have preferred that the Government reimburse the trust funds for revenue lost in periods of high unemployment. A certain amount of general revenues could be infused for each percentage point of unemployment. I think that would be a fair thing to do, but the other colleagues wouldn't agree to that.

So we have a package. The first thing and one of the most notable accomplishments of this Commission was to tell America what the problem was and we divided it into two parts, the short-term part and a long-term part.

The short-term part relates to the period between 1983 and 1989 primarily, since we enter a period of surplus in 1990. The extent of the system's needs during that period depends primarily upon the state of the economy. If the economy performs according to the best-guess estimate, what we call the II–B assumptions, then all we need is $60 billion. According to the pessimistic assumptions, the economy is very bad, then we may need $150 to $200 billion.

We undertook to give assurance that we would raise for the people who are eligible for social security the amount required to finance benefits even under pessimistic assumptions. This package gives you $168 billion. So we met our requirements and we have avoided embarrassment to this honorable committee and to the Congress, by improving on what we didn't do in 1977. In 1977 we used assumptions which took too rosey an outlook upon the economy. We didn't anticipate the recessionary character of this economy, and so we didn't provide for it in our arrangements of that time.

We have provided for the possibility of poor economic performance in the package that we present to your honorable committee. We provided $168 billion in dependable revenue for the period between 1983 and 1989. If the economy performs poorly, the package will raise $185 billion. Now then, Mr. Chairman, I mentioned two major concessions made by the system's beneficiaries. These are the cut in the COLA, and the subjection of recipients of social security to a small income tax liability. But what do we get in return? What do we get for the elderly?

Look at the polls lately, Mr. Chairman and members of the committee, and what will you see? Half of America is casting doubt upon the survival of social security, doubtful as to whether it will survive or not. The young people cynically accusing us of ripping them off of their hard earned wages to put their money in a rat hole that will yield back nothing; that when they get eligible at 62 or 65, there won't be any social security.

With this package we give them the assurance of the President and the Congress of the United States that if the President approves this package we have assured the solvency and the soundness of social security for 50 years. Now, I said 50 years, not 75 years decidedly. I thought we should have stopped at the estimate of 50 years. Nobody can tell what conditions are going to be like out there 50 to 75 years from now, or, for that matter, the year after next. We don't know what the birth rate is going to be out there 75 years from now or 65 or 70 years from now. We don't know what the death rate is going to be. We don't know what the retirement rate is going to be. We don't know what economic conditions are going to be.

However, it was the consensus of the Commission that to eliminate any doubt in the minds of young contributors, the Commission report should address the entire problem projected over the next 75 years. You will note, Mr. Chairman, that the consensus agreement, so far as it goes, addresses the entire short-range problem and more than two-thirds of the projected problem over the next 75 years. Unfortunately, we couldn't come to an agreement over how to resolve the remaining one-third.

Not wanting to appear to shirk our responsibility to resolve the entire problem, we agreed to make two separate recommendations for addressing the shortfall left unresolved by the agreement—about 0.58 percent of payroll.

Eight of the Commission members appointed by the Republican Party recommended that the age of entitlement to full benefits be raised to 66 by the turn of the century, and indexed to longevity thereafter. On the other hand, the five of us appointed by the Democratic Party recommended a contingency tax increase of 0.46 percent in the year 2010. We believe that, in the future, the law should stand as it is today, giving assurance to the people that when you pay into social security you get back what the law says you are entitled to receive when you make those payments.

We do not believe that it is possible to tell exactly or with authority what the situation will be three-quarters of a century away. But insofar as there is a need, it can be met by a variety of means, including a very modest increase in the payroll tax.

Even without this provision we are within the margin of safety that the analysts generally prescribe for this kind of an estimate: 5-percent variation. The social security actuaries consider the system within close actuarial balance if the estimated taxes are within 5 percent of the estimated benefits. We are only 4 percent short according to the estimates that the actuaries made. So even if you didn't do anything beyond the consensus package, we would be within less than 5 percent of the estimated need for the next 75 years.

I do want, Mr. Chairman, to urge one thing, if I may. As I said to you, my honor is committed not to cut social security benefits. If we put one item in there cutting social security benefits, I cannot support this bill. Otherwise, I support it wholeheartedly and will do everything I possibly can before the country and before your committee and in the House and wherever I can be of any help.

Please don't mar this record that we have made. Outside of a 6-month COLA delay, we haven't cut a nickel out of the benefits.

And so, Mr. Chairman, I come to you today and I say, "yes, we don't like a lot of things in this package." I heard Chairman Greenspan say that hardly any member of this Commission thought there wasn't some part in that package that he or she didn't like. But we couldn't get the package that we wanted.

If you have a bargaining, you have to give something if you are going to get anything and it is not unusual for us in life to learn that there are no free lunches and we simply have to make a concession.

But I am saying to you as a member of the elderly and a friend of the elderly, it is to the interest of the elderly of this country that we embrace this package before your distinguished committee and I hope the members of this committee will help us to put it through the Congress and it will establish to the people of this country, just as we saved New York, just as we saved Chrysler, just as we saved Lockheed, just as we saved the Pennsylvania Railroad, we have come in now with one of our Nation's most momentous accomplisments: We are saving social security for 75 years without any cuts in benefits. That is a good deal for the elderly of America and I am glad to be identified with it.

Thank You, Mr. Chairman.

Chairman ROSTENKOWSKI. Thank you, Mr. Chairman. Thank you for your outstanding observations and statements.

Are there any questions?

Mr. PICKLE. Mr. Chairman, I don't know that I have any questions, as much as I want to make a general observation to the Senator with whom I have no greater affection for any man in America.

When you take the position that you would have trouble supporting this bill if we cut benefits, I trust, in essence, you are making reference to cuts in present benefits in years to come. We don't know how to handle that, but I want to make plain that you leave open this question about what we do in the future.

Mr. PEPPER. I am sorry. If my dear friend will permit me, I don't make any distinction between the present and the future. I think if I am entitled to receive my benefits at 65, a man out there in 25 years who gets to be 65 should be similarly entitled, unless conditions get to be such that the Congress in approximately that period might come to a contrary judgment. But when I say don't cut benefits, I mean now or hereafter. Leave the law as it is with respect to benefits.

Mr. PICKLE. You pose a problem for all of us in the Congress over and above your individual preference and I am not going to question you what you want because we know where your heart is and what you tried to do and you have done so valiantly here in the last year or two. But we have got this problem.

You, as a member of the Commission, have recommended we make the long-range changes. That is important. We must do it or we are going to lose the confidence of our young people, and though you and I will not be in the Congress forever—you may think you may be, we won't be—we have people coming up in 20 or 30 years who are entitled to know that that fund will be there. That is important, more so than individual changes. In the long run you agree that should be done, and now you tell me if you do it in any way that affects the benefits, you might not be able to support the package.

I would say I hope that you counsel with yourself and give us the chance to visit with you about the problem.

You list four options in your statement about how you would settle the long term. The first one is to raise taxes.

The second is to have general revenue and to raise taxes. The third is general revenue, raise taxes and raise the wage base and four is to tax the entire compensation. Obviously that is what you prefer, but I want to say to you that there are other recommendations that the committee must consider, the possibility of raising the age in the future so people can stay in the work force longer, an absolutely inevitable development in the history of our country as I see it. Or perhaps in slowing the growth of the benefits so that ultimately down the road there would be some reduction in the replacement rate.

Now, those are two options that we have got to consider.

I would say we must raise taxes in the year 2010. That is an option. I would be just as difficult to deal with on that question as you. I hope we don't get locked in a position that you have to have it just your way.

Yesterday, five out of six members of the Commission said that when we raise taxes, raise the age or when we have a slowing in growth benefits, we still must vote for the package, and I trust the gentleman from Florida would take basically the same position. Otherwise, you are going to have it your way or not at all.

I know you don't intend that, so I counsel with you to give us a chance to help work out a way in this committee without saying you are going to have it that way or else.

Mr. PEPPER. Mr. Chairman, if my distinguished friend—and I have no better friend in this Congress than he—if he will allow me. In the first place, our group, we five Democrats who worked together on this Commission, we recommended one thing; namely, increase the payroll tax to the extent necessary, relatively a small increase. According to the estimates the Commission used, the alternative II-B assumptions, no real increase, on the part of the working people in the amount that they pay, would be necessary. Even if a modest increase becomes necessary in the year 2010, this increase would be levied on a smaller proportion of workers' incomes than is the case at present. So the burden on individual workers may actually shrink in the future.

But we are trying preserve a meaningful structure. We know that if you start ripping at it here, cutting off over here, reducing it there, what you have left is a hollow shell. Many of us have been here long enough to know the struggle we have had to bring social security to the level it is now. If you use the easy approach and say, "well, cut those people out there in the future, they are not here to protest it," you have destroyed the meaning of the social insurance compact.

There is nobody here this morning who will be out there at 2000 or 2025 or 2050. We are all here and we don't bother with them. They are not here to protest: I am saying they are human beings just like us and they will have the same needs that we have today. If anybody is to do anything, let's let it be a Congress of more proximate time and more familiar with the facts of the situation. Let's not build together this beautiful package without a cut in benefits and then way out here 70 years from now, put in some cuts in benefits or raise the age of eligibility.

There are other means by which we can do whatever needs to be done there. Please don't mar the symmetry and excellence of this structure by cutting the benefits.

Mr. PICKLE. We are not trying to mar, but we must fill in what you are trying to do. We must say that we in the Congress have a duty to the American people to pass this bill more than we do in trying to have our way on every particular point. We owe that to future generations and we must adhere to that.

Mr. RANGEL. I just want to thank Senator Pepper for the contribution he has made on the Social Security Commission. I know that you have had pretty hard decisions to make and you also know that there are many Members of Congress locked into the position that you have taken in the well-founded belief that the decisions that you made are in the best interest of the senior citizens of our country. I know that you have had some trying times and I just want you to know that while the ball has been passed to the Ways and Means court, we are deeply appreciative to you for making our job a lot easier than it was before your deliberations.

Mr. PEPPER. Thank you very much, Mr. Rangel.

Chairman ROSTENKOWSKI. Mr. Duncan?

Mr. DUNCAN. I would like to compliment you, Senator Pepper, on the long time and effort that you put into this really complex subject; but above that, I would like to compliment you on a letter that you wrote on January 19th to the Commissioner of Social Security, and I think it was due, where you rebuked the Democratic National Committee for using this kind of envelope and letter without permission. I think that was a noble thing for you to do.

Also, I thank my colleague, Mr. Jacobs, for informing the committee that these funds are not going into a trust fund as far as he knows and are not being used for the purposes for which they were to be used.

Mr. PEPPER. I thank the gentleman very much.

Chairman ROSTENKOWSKI. Thank you very much, Mr. Chairman. We enjoy having you here.

Mr. PEPPER. I thank the members of the committee.

Chairman ROSTENKOWSKI. Senator Heinz?

Thank you, Senator, for joining us this morning. The committee is awaiting your comments and observations and we, too, would like to express our gratitude for the services that you rendered with respect to the packaging of this social security program. If you are ready to proceed, the committee is ready to receive your testimony.

STATEMENT OF HON. JOHN HEINZ, A U.S. SENATOR FROM THE STATE OF PENNSYLVANIA, AND A MEMBER OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Senator HEINZ. Mr. Chairman, thank you very much. It is a pleasure to be before the Ways and Means Committee and I would ask unanimous consent that my entire prepared statement be made a part of the record.

Chairman ROSTENKOWSKI. Without objection, it will be received.

Senator HEINZ. I intend to summarize my complete statement. Let me start by saying that the the outset, I think each member of the 15 members of the National Commission on Social Security Reform had in mind a variety of different solutions to this problem. Claude Pepper has spelled out some of his own propositions.

For myself, I saw the mission of the Commission as three-fold. The first was to promptly address a very important emergency situation, the exhaustion of the OASDI trust fund, even if we had extended interfund borrowing, sometime in 1984 and, thereby prevent an absolute catastrophe for our social security system.

The second objective or principle was to address the fact that 3 out of 4 Americans under age 45 simply don't believe there is going to be a social security system when they retire, by restoring the long run solvency of social security. So the second objective was to adopt a series of recommendations from the Commission that would restore confidence not just for these 36 million Americans who depend today on social security, but to the over 100 million working Americans who, with their families, are looking forward to having that social security system still in place, still functioning when they retire.

And finally, many of us were determined that we would solve this problem in a way that would be balanced and fair to all who are affected in one way or another by the system.

Let me start then, Mr. Chairman, by saying that I fully support the total package that the Commission has recommended. I do believe that it is fair and reasonable. Of course, this is not the recommendation any single member of the committee would have proposed, left to his or her own devices. It is the product of compromise. There are elements in the package that, taken separately, would in varying degrees be unattractive to each of us. Taken as a package, however, I believe they fairly balance the burdens of financing social security.

It is this balance that has been rather important in gaining support of some very diverse people. The President of the United States, the Speaker of the House, and the Senate majority leader are behind this package, as are 12 of the 15 members of the Commission, and I believe that their support is very important to helping this committee, and you, Mr. Chairman, meet your responsibilities and successfully do your job.

I trust we all know that ultimately there is no painless solution to social security financing problems, but I believe that the Commission's recommendation spread that pain just about as evenly as it is possible to do. Of the $168 billion in the total package, about a third of it would affect employers and employees. Another third would affect other accounts in the budget and a third would affect beneficiaries. Because the financial burdens are shared evenly and broadly, they are minimal for any particular group.

Now, Mr. Chairman, I have a chart that I hope will be helpful to the members of the committee. It demonstrates that the timing and sequence of implementing various proposals included in the package would help cushion the impact on any particular group.

The substantial immediate need for social security financing is going to be met in the short-term from accounts in the budget, a portion of which are general revenues, in order in 1983 and early 1984 to avoid having to resort to drastic benefit cuts or a drastic payroll tax increases.

As you will also note, fully half of the taxes on employers and workers are not felt until 1988 and 1989. What we have done is to defer those kinds of effects largely due to the fear of members of the Commission that there might be some adverse affect on employment.

For beneficiaries, the effect is spread relatively evenly over this 7-year period, with the effects felt more in the later years than in the earlier years.

Now, one other point I would like to make here, Mr. Chairman, in talking about payroll taxes. Some groups have expressed concern that the tax burden in this package would be excessive, that it will adversely affect employment because high payroll taxes have that effect.

As I said, only 32 percent of the entire package falls at some point in time on workers or employers, and only 14 percent of the effect on workers and employees would be felt during the first 5 years. Overall, net changes affecting workers account for only 9 percent, and those affecting employers about 12 percent of the total $168 billion financing package.

Now, another concern that has been voiced is that this package relies too heavily on transfers within the budget or general revenue financing and that it does not do enough to reduce budget deficits. Intra-budget transfers and coverage of new Federal employees will account for only 30 percent of the total financing in the package. Only about 3 percent of the total revenues the social security system is going to receive between 1983 and 1990 are going to come from these revenue sources. That is because over this period, we are talking about a grand total of $1.5 trillion in revenue being received and only a total of $51 billion from sources within the budget.

I would like to make note of one other point that has come up, Mr. Chairman, and that is the issue of covering new Federal employees. There has been some concern about what this could do to either Federal employees benefits or to the budget. I think there has been some misinformation about this.

I would particularly like to emphasize that covering new Federal employees under social security is going to help a large number of Federal employees. About 75 percent of all Federal employees leave Federal Government service before they reach retirement, and fully half of that 75 percent never receive any pension benefit at all from the civil service retirement system. Coverage under social security will provide portability for at least some portion of their pensions for the new Federal employees. This could have particular benefit to women who tend to have the most intermittent attachment to the work force. I look at that as a real benefit to a very large number of people.

Second, there are some people who say that coverage of the new Federal employees plus maintaining promises and commitments to existing Federal employees is going to cost the Government a lot more money. Mr. Chairman, I have looked very carefully at a variety of detailed proposals, and I don't believe that is going to prove to be the case.

One of the reasons it should not cost more is that newly hired employees will be working longer. Federal retirees on the average now retire 3 years earlier than social security beneficiaries. That, for new Federal employees under social security and a supplemental pension program will not be the case. We will eliminate that difference by shifting from one system to the other. It makes a very large difference in dollars and it is for that reason that I do not expect the combined two net sytems to cost any more over the longer term than the present system.

Mr. Chairman, finally I would like to make a few comments about the beneficiary groups that are affected. Some groups, if not all, have expressed concern that the financing package is going to place a disproportionate burden on beneficiaries. In fact, about a third, 38 percent of the solution is going to be borne by beneficiaries. It does not, in my judgment, constitute an undue burden on any group of beneficiaries. The $64 billion we are talking about is split between the 6-month COLA delay and the taxation of benefits of upper income social security beneficiaries.

Probably for many members, the taxation of any portion of social security benefits is rather controversial. I have expressed in the last Congress on a couple of occasions my misgivings about taxing social security benefits.

One thing we have to be clear about, we are talking only about taxing that portion of benefits that has always been untaxed because it has been contributed by the employer. We are talking not about taxing the whole benefit, but about taxing half of it. And we are talking about taxing benefits for a group of people who will have adjusted income of $20,000 single and $25,000 if couples and who represent about 10 percent of all the social security beneficiaries, the wealthiest 10 percent.

I think we would all prefer not to get into the issue of taxing social security benefits in any way, shape or form. But when you consider all the other alternatives, this would appear to be the best of what is an unpleasant lot.

In short, Mr. Chairman, I think we have a package here that is a good package. It deserves to be supported by the Congress, by the House and the Senate.

I know, because I have wrestled with this myself, that there are some things I would like to see a little bit different here or a little bit different there in the package, but I have to caution all my colleagues and my breathren on this side of the Capitol that I think any of us that would undertake to change this package do so at great peril.

First, any change in the balance of this package will affect our ability to enact any kind of social security legisation. This package is a compromise carefully crafted to get the support of people with views as different as those of Claude Pepper and Ronald Reagan. They both have pretty different ideas about the social security system and what they would like to see. I would hate to see Humpty Dumpty fall off the wall and be responsible for putting him back together if I were the person who shoved him, and I hope that Members of both bodies bear that in mind.

The second point I would make in that regard is that anybody who really seeks a major change in this package and succeeds in getting some part of the package changed, had better be sure it is going to pass the House, it is going to pass the Senate, and the President is going to sign it because if that doesn't happen, the burden of saving social security is going to fall on that individual, that group.

Finally, Mr. Chairman, I would like to discuss briefly four areas that are largely technical, which I hope the Ways and Means Committee and the Finance Committee on which I serve will attempt to address.

The Commission only agreed upon solutions for about two-thirds of the long-run short-fall of 1.82 percent of taxable payroll. We have come up, as a Commission, about 0.58 percent taxable payroll short.

It is to me essential that that one-third of the remaining problem be addressed. It is my belief that the members of the Commission, in agreeing to disagree on how to solve that problem, are also agreed that they would let the chips, fall where they may on that issue whether they liked them or not. If a solution were enacted by the majority of both Houses and worked out in conference for the conference report, that that was not going to cause any single member of the Commission to withdraw his support for the 100 percent of the short-term package and for two-thirds of the long-term package.

Now, I am personally 1 of 8 members of the Commssion who have supported raising the retirement age by exactly 1 year fully effective in the year 2015. There may be better ways of doing it, but I think that is a credible way. I don't think it places an unfair burden on anybody. We have longevity that is increasing and improving. We can expect increases in morbidity at the same time.

If we are ever going to make any change in the retirement age, we want to do it with as long a lead time as possible. What we are talking about in terms of somebody who would be age 65 or 66 in the year 2015 is somebody who would be under 35 today. That is a long-lead time and it is the right kind of lead time to have.

But the other side and the favorable side of that coin for all people is that maybe, before we start to implement this proposal in the year 2003, we will find a better solution than increasing the retirement age. Maybe some of the fertility trends will change. Maybe labor force participation will change.

There are a lot of things that may change. We don't know if they are going to change and we had rather be safe than sorry.

If you find a better solution, you can change this recommendation 5, 10, or 15 years from now, but you cannot enact it then as fairly as you can this year. It would be harder to do it 5 years from now and next to impossible 10 or 15 years from now.

The second area of concern to me, Mr. Chairman, is that we don't, through the delay in the COLA to January, unintentionally reduce the income of those on supplemental security income. There are about 2 million senior citizens who receive both social security, and because this is inadequate, SSI. The Commission recommendations left unsettled the question of how to schedule the SSI COLA. The SSI COLA will be delayed along with the social security COLA unless it is explictly uncoupled. If it is delayed, the increase recommended by the Commission in the disregard for social security income will only protect 2 million SSI beneficiaries. Whatever is done, an effort should be made to maintain the real value of the SSI benefit for the 4 million elderly and disabled who depend either singly on supplemental security income or jointly on SSI and social security.

Third, the tax deduction for the self-employed is going to afford fullest protection only to those self-employed with the highest incomes. Those with low incomes will bear nearly the full burden of the increased self-employment tax. While it may be necessary for the self-employed as a group to pay more in net taxes along the lines suggested, I believe that it is important that the burden be distributed as equitably as possible among them.

Fourth, the Commission proposal to tax social security benefits, if left exactly as it is, is going to result in an undesirable notch. That is to say someone with an adjusted gross income of $19,999 wouldn't pay any additional taxes if they had, let's say, a $6,000 social security benefit, but somebody who had an adjusted gross income of $1 more would find fully half of their $6,000 social security benefit subject to tax.

That is a notch, obviously. We don't like having those kinds of things in the tax law, because they result in very inequitable situations. It seems to me that it can be easily corrected. For example, it would be possible to tax individuals only on the amount by which his benefit takes him over the outoff when added to his adjusted gross income.

That, in particular, is a relatively technical problem. I don't believe any of these problems can't be resolved. I think in resolving them, they will only improve the fairness of the total package.

Mr. Chairman, in conclusion, I want to commend the Ways and Means Committee for scheduling these early hearings. As you know, the Senate Finance Committee will be following you in a matter of weeks. The action that you take will send a signal to the country that after several attempts, in the past several years the Congress is very definitely going to take action on it in a responsible way.

Mr. Chairman, I know of your great commitment to solving this problem. I commend you, Jake Pickle, Barber Conable and others on this committee who I know have taken it seriously all along and have been trying to solve the problem.

We hope that this will make it a little easier.

[The prepared statement follows:]

STATEMENT OF SENATOR JOHN HEINZ, MEMBER, NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Mr. Chairman, I would like to thank you for providing me this opportunity to appear before the committee as a member of the National Commission on Social Security Reform to discuss our consensus recommendations.

A FAIR AND BALANCED PACKAGE

The recommendations of the National Commission, taken in their entirety are, I believe, entirely fair and reasonable. There are, of course, individual elements of the package which are unattractive by themselves. Indeed, any proposal in this package, or, for that matter, any single proposal on social security, taken by itself, would be unlikely to receive support from a majority of Members in either the House or the Senate. However, taken together the proposals in this package fairly balance the burdens of financing social security to assure solvency in the coming decades.

It is this balance which has been so important in gaining the support of the President, the Speaker, and the Senate Majority Leader, and will, I believe, be key to the success of a social security financing package in the Congress. Ultimately, there is no painless solution to social security's financing problems. But the Commission's recommended package spreads the pain that there is as evenly as possible. About a third of the $168 billion in new financing would affect employers and workers, another third would affect other accounts in the budget, and a third would affect beneficiaries. Because the financial burdens are broadly shared, they are minimal for any particular group of individuals.

In addition, the timing and sequence for implementing the various proposals in the package is designed to cushion their impact. The substantial immediate financing need in social security would be met primarily through transfers from other accounts in the budget. A transfer of $18 billion from the general fund in the first year would provide over 80 percent of the financing needed initially, and would avoid having to resort to immediate benefit cuts for increased payroll tax rates. For the next four years, intra-budget transfers would play a minor role, while significant payroll tax increases would be postponed until 1988 and 1989 to mitigate any adverse consequences for economic recovery. As a result, between 1984 and 1987, changes affecting beneficiaries, then beginning to take effect, would supply half of the financing during this period. Finally, the acceleration of the 1990 tax rate in 1988 and 1989 would provide half of the revenues needed at the end of the seven years. The sequencing of the National Commission's recommended proposals makes it possible to provide sufficient financing for social security in the early years without drastic or immediate changes in the structure of the system.

EMPLOYERS AND WORKERS

Some groups have expressed concern that the tax burden from this package would be excessive. Yet over the seven year period, only 32 percent of the financing of this package would affect workers and employers. Furthermore, these proposals would not increase social security tax rates beyond those already scheduled in the law. The schedule that exists for rate increases would be stepped up, however, and the rate for the self-employed would be set equal to the combined employer-employee rate. In the first five years, the effects of these changes would be relatively small—producing only 14 percent of the total financing in the package during this period. Three-quarters of the net new tax payments would be made in 1988 and 1989. Even the 1988-89 acceleration would only raise rates for those years by 0.36 percent each on employer and employee, for a net increase of about 4 or 5 cents per hour per job. Of the total financing in the seven year package, only 12 percent would come from net additional taxes on employers and only 9 percent from employees.

The self-employed, who have been paying three-quarters of the combined employer-employee rate because they cannot deduct the tax as a business expense, would have this situation reversed. The self-employment tax rate would rise by 3.35 percent in 1984, but half of all OASDI taxes would be deductible. Because the tax deduction would only offset the added social security tax for those at a 50 percent marginal tax bracket, most of the self-employed would have a net tax increase. For the average self-employed individual the net increase would amount to about $5.80 per week.

In addition, some employees of non-profit organizations would join social security. Over 4 million non-profit employees, 85 percent of all non-profit employees, are already covered, and nothing would change for them. Only 15 percent of the nonprofit employees would pay new taxes. For many, these added taxes would be partially offset by a reduction in payments to alternative pension and insurance plans.

INTRABUDGET TRANSFERS AND FEDERAL EMPLOYEES

Other concerns have been voiced that this package relies too heavily on transfers within the budget and does not do enough to reduce budget deficits. In fact, the smallest portion of the total financing would be provided through changes that will only affect accounts within the budget. Intra-budget transfers and coverage of new federal employees will account for only 30 percent of the financing in the package and about 3 percent of revenues from all sources that social security will receive during this 7 year period. About half of this amount is realized almost immediately so that neither outright benefit cuts nor new payroll tax increases will be necessary.

The largest single transfer is an immediate, one-time $18 billion payment to compensate for inadequate social security tax contributions for military personnel in the past. In later years, the largest effects on other budget accounts will come from reduced tax revenues due to the fix deduction for the self-employed and the 1984 tax credit.

New Federal employees hired after the end of 1983 would pay into and be covered under social security, rather than make contributions to the civil service retirement fund. This proposal would not increase contributions for new employees. Nor would it necessarily affect the earnings replacement provided thorugh their pension benefits, since they would be offered a largely employer-financed supplemental retirement plan. It is important to note that this change would be beneficial to those Federal employees who work only partial careers in Federal service, since it will provide them with fully portable social security credits for that service. Under the current system, half of the Federal workers who leave the Government before retiring receive no Federal pension benefits. There has been some concern on the part of Federal employees that this proposal would jeopardize the financing of the current retirement system, because it would raise the cost to the taxpayer of retirement programs for Federal employees. In fact, coverage under social security would almost certainly reduce the annual budget cost of Federal retirement, quite simply because Federal employees hired after this year would work an average of three years longer before drawing retirement benefits. Today the average retirement age is 64 for a social security retiree compared to 61 for a Federal employee.

BENEFICIARIES

Finally, some groups have expressed concern that the financing package would place a disproportionate burden on beneficiaries. In fact, 38 percent of the total financing package comes from provisions affecting beneficiaries—much of it affecting only the wealthiest beneficiaries. There is no doubt that these changes will it somewhat more difficult for many retired persons to maintain their living standards, but taken in the context of the other financing measures, they are fair and modest. The six month COLA delay would pay the scheduled July 1983 benefit increase in January 1984. As a result, an average retired beneficiary receiving $416 a month in benefits would still receive the full $22 per month increase, but it would come six month late. Two million of the poorest social security beneficiaries would be fully compensated for and protected against the six month delay through an adjustment in their monthly SSI payment amount.

The wealthiest 10 percent of the social security beneficiaries will also begin paying income taxes on the half of their benefits related to tax free contributions of their employers. Under the Commission's proposal, people receiving social security benefits with additional income in excess of $20,000 (single) and $25,000 (joint) would begin in 1984 adding half of their social security benefit to taxable income. A single elderly taxpayer with an adjusted gross income of $30,000 and $6,000 in social security benefits would pay less than 2 percent of his or her income in additional income taxes between 1983 and 1984. These changes would still leave the relatively wealthy elderly with more favorable tax treatment than the non-elderly. A non-elderly taxpayer with the same gross income and deductions as this elderly individual would pay $1,029 more in income taxes in 1984, in addition to the social security and other payroll taxes he pays that the retired person does not.

In short, the social security proposals recommended by the Commission would affect a broad range of individuals, but should place an undue burden on none. This is a package that carefully balances the concerns of workers and beneficiaries and the interests of the various groups involved. Most importantly, it is a package that will restore solvency to social security for several decades.

REMAINING CONCERNS

That is not to say that this is a technically perfect package. Clearly, there are a number of areas in which this Committee and the Senate Finance Committee will be modifying and improving the package. I would like to discuss briefly four areas about which I have concerns.

First, while the Commission recommended the entire long run financing shortfall equal to 1.8 percent of taxable payroll be eliminated, there was consensus among the members on changes to eliminate only two-thirds of the shortfall. I believe we must fully resolve the long-run financial problem in order to restore public confidence in social security. Within reason how this is done is not nearly as important as that it be done. I have supported, in the Commission, a gradual increase in the retirement age to age 66 by 2015, with further increases in the future to maintain a constant ratio between years of work and years of retirement. This is conditioned on the premise stipulated in the recommendation that it be coupled with improvement in the disability insurance program to meet the special needs of those precluded by poor health from working longer. This gradual change should complement the effort we as a nation should make to expand employment opportunities for older workers.

A second concern I have is that in delaying the social security COLA to January, we not unintentionally reduce the incomes of those on social security or SSI. I raise this point because the Commission recommendations left unsettled the question of how to schedule the SSI COLA or the SMI premium increase. With regard to SSI, the COLA in that program is currently tied to the social security COLA. The SSI COLA will be delayed along with the social security COLA unless it is explicitly "uncoupled". If it is delayed, the increase recommended by the Commission in the disregard for social security income will only protect 2 million SSI beneficiaries. Whatever is done, an effort should be made to maintain the real value of the SSI benefit for the 4 million elderly and disabled who depend on this program. In addition, a supplementary medical insurance (SMI or Medicare part B) premium increase is scheduled for July. The effect of this increase combined with a six month delay in the social security COLA could be to actually reduce the monthly incomes of some elderly beneficiaries. It is important that the SMI premium increase be delayed to avoid this unintentional effect. While these issues are not strictly social security financing concerns, they will inevitably be addressed, either directly or indirectly, in the financing legislation.

A third concern I have is that the tax deduction for the self-employed will only afford full protection to those self-employed with the highest incomes. Those with low incomes will bear nearly the full burden of the increased self-employment tax. While it may be necessary for the self-employed as a group to pay more in net taxes, it is important that the burden be distributed as equitably as possible among them.

Fourth, the Commission proposal to tax social security benefits would result in an undesirable "notch", as the Commission indicated in its recommendations. An individual whose adjusted gross income is one dollar above the $20,000/$25,000 cutoff would pay tax on half of his social security benefit, while an individual with an income a dollar below the cutoff would pay no tax on his benefits. This inequity can be easily corrected, for example, by taxing the individual on the amount by which half his benefits take him over the cutoff when added to his adjusted gross income.

These are only relatively technical problems, and in no way detract from the overall fairness of the total package.

Mr. Chairman I believe that the Commission's recommendations overall provide an excellent foundation for an early legislative remedy to social security's urgent financing problems. The package of proposals recommended by the Commission is an equitable, comprehensive, and realistic means available to the Congress to restore social security to financial health. And, we in the congress have no more important responsibility than to restore the public's confidence in our most successful and most important social program.

Social security proposals a balanced package

	Billions
Workers and employers:	
Payroll tax increase net of tax credit payments ($4,000,000,000)	$36
Self-employed tax increase net of tax adjustment from deduction ($12,000,000,000)	6

Coverage of nonprofits/prevention of State and local terminations	11
Total (31.5 percent)	53
Beneficiaries:	
6 mo. COLA delay net of increased payments from SSI	35
Women's equity net ($1,000,000,000)	−1
Taxing benefits	30
Total (38.1 percent)	64
Federal employees and intra-budget transfers:	
Coverage of new Federal employees	12
Payment for Military Service Credits	18
SSI payments to beneficiaries (see above)	5
Income tax adjustments to workers (see above)	16
Total (30.4 percent)	51
Grand total	168

DISTRIBUTION OF SOCIAL SECURITY SOLVENCY COSTS

[By category and year; calendar years (in billions of dollars)]

	1983	1984	1985	1986	1987	1988	1989	Total
Employer/employees		5	2	2	4	19	21	53
Beneficiaries	4	5	8	10	11	12	13	64
Intra-budget transfers	21	5	3	5	5	6	6	51
Total	25	16	13	17	20	37	41	168

Note.—Some totals may not equal the sum of individual items due to roundings.

Chairman ROSTENKOWSKI. Mr. Conable?

Mr. CONABLE. Mr. Chairman, I don't have any questions, but I do want to comment here publicly and on the record that the considerable concern the gentleman from Pennsylvania brought to the Commission proved to be a very important catalytic factor in the development of a bipartisan resolution. Bipartisanship is terribly important not at any price, but through true negotiations. The gentleman contributed very significantly to that and I want to express my gratitude for it.

Senator HEINZ. I thank the gentleman from New York.

Chairman ROSTENKOWSKI. Thank you very much for joining us. I am sorry. I think there is a question.

Mr. GUARINI. I just have one question, Mr. Chairman. Do you have any opinion as to whether Members of Congress should be put under social security? As you know, Mr. Wright testified about that this morning and there is a feeling on his part that sacrifice should be made by Congress if we are to lead the Nation and show the way.

Senator HEINZ. Let me put it this way. I think Members of the Senate should be under social security.

Mr. GUARINI. Well spoken.

Mr. CONABLE. May I ask a question following that up, however? Don't most Senators make enough money from honoraria that if they were included as employees under social security, there would be a tax reduction for them because they would not then pay the self-employment tax?

Senator **Heinz**. I think the gentleman is going to have to ask a different Senator, for that because this Senator when he collects an honorarium, gives it immediately to a charity.

Mr. **Conable**. However, I am sure being the distinguished person he is that he has to pay income tax on it regardless of whether he gives it to charity.

Senator **Heinz**. Having heard what I just heard, I think I may have to claim shelter under the fifth amendment.

Mr. **Conable**. I deeply regret having caused any personal embarrassment for the Senator from Pennsylvania.

Senator **Heinz**. Before I return for any further questioning, I am going to consult with legal counsel.

Chairman **Rostenkowski**. It is easier for us to say that we pay social security taxes, too, when we ask our Federal employees to join in that effort; isn't it?

Senator **Heinz**. Yes.

Thank you, Mr. Chairman. I appreciate being with you. Any other questions, or can I escape with my life?

Chairman **Rostenkowski**. Thank you, Senator.

Senator **Heinz**. Thank you.

Chairman **Rostenkowski**. Martha Keys?

Ms. Keys, it is a pleasure to have you with us again. I am sure that I am not the only one who can recognize you have made a great contribution, not only to the effort in the compromise on social security reform, but as a member of this committee. We certainly appreciate all your service. If you are ready to begin your testimony, the committee is ready ro receive it.

STATEMENT OF MARTHA KEYS, FORMER MEMBER OF CONGRESS, MEMBER, NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Ms. **Keys**. I certainly thank you, Mr. Chairman. I congratulate all of my former colleagues that I served with on this committee, because I note that every one of them is now up on the upper row.

It is a pleasure to be here and thank you for the time given to me and I would like to introduce my written testimony for the record and speak briefly.

I support the package. I think it is a good and fair package. I certainly don't intend to comment on each part of it, as you have so much excellent testimony from other Commission members, but I would like to spend just a brief amount of time just talking about the four specific recommendations that this Commission made for changes that are important changes for very small numbers of women beneficiaries.

I want to note the reasons these were made and the reason the Commission quite appropriately could not give a large amount of time to the consideration of the broader problems that exist for women beneficiaries. It is certainly appropriate that the Commission spent the majority of its time on the serious financial problems, because assuring that there were appropriate revenues for the difficult 7-year period ahead is the most important thing for all of the 36 million beneficiaries, more than 19 million of whom are women, about 13 million are men and about 9 million are children.

There are, however, because of the tremendous changes of women in the society and the economy in recent years, growing concerns and growing understanding of severe problems that exist for women beneficiaries, largely because of unintended consequences. There has certainly been a doubling of women in the work force in the last 25 years. There has been more than a doubling in the divorce rate and really these are the facts, the societal changes that cause the severe problems for women.

The Commission recognized in its report and in supplemental remarks that it could not give sufficient time to a broad study of these issues and yet I think it is important to note that we did feel and include in our recommendations four specific changes that, while small in dimension and affect only small numbers of women, they are very important changes to those particular women that they affect.

The recognition of that caused them to be included in this because they were severe problems that could be easily changed.

I would just please ask the indulgence of the committee to briefly address the other problem and unintended consequences that do exist for women beneficiaries. Though a majority of working age women, that is 65 percent now are in the work force, many of those women will have low returns on their contributions to the social security system. Those will occur primarily because of years that they chose to spend in full-time homemaking or child rearing. This will result in a lower benefit many times to the point that the benefit that they have as vested eligibility in their own right is lower than a dependent benefit that they might receive if they are married.

In 1979, 2½ million women found themselves in this circumstance of having vested eligibility as a worker, but finding when they reached retirement age that their benefit is no more than it would have been as a dependent had they not worked at all.

Indeed, two-wage earner couples in retirement and a survivor of those couples also have lower benefits in retirement and survivor benefits than one wage earner couples because of the impact of the system primarly on working women who are married as well.

There are other problems for women. There is no coverage at all for homemakers. No individual eligibility. That means that they have no credits at all on which to build with later employment, whether it be caused by early widowhood or any other reason at all. There is certainly a very severe effect upon divorced women of the arbitrary 10-year duration of marriage requirement. And, indeed, the 50-percent dependent benefit to which they may be eligible is certainly not sufficient to their independent needs. Only women who work for very continuous periods of time in the work force have disability coverage and many working women lose this coverage when periods of time are spent in the home.

These problems are largely unintended consequences and can be remedied. Since I introduced, with Representative Fraser in 1976, legislation to implement the concept of earnings sharing, I have always sincerly believed, continue to believe, and a belief that is shared by many others, that this is an approriate solution to the whole range of these problems.

Earnings sharing primarily respects marriage as an economic contract and it gives equal respect to whatever division of labor is chosen by the couple. It would mean that there would be a sharing of the retirement credits, each individual of the couple would have an individual retirement right based on half of the retirement credits earned by the couple during the duration of that marriage. It would mean that there would be a continuous work record for both spouses. There would not be zero years for time that was spent in full time work in the home. It would, indeed, bring an economic respect and recognition of the economic value to the couple of full time work in the home performed for a period of years by either spouse.

It is very clear that a change of this magnitude would require the development of a very careful piece of legislation. It has been recommended by the 1979 Advisory Council, also by the President's Commission on Pension Policy, by a number of other study groups. It is supported by a number of groups in the private sector, not only women's groups, but other organized groups who have studied the system. It is clear that there is a great deal of technical and admnistrative work that needs to be done on such a proposal. One would have to be very careful not to diminish the family protections in case of the death or disablement of the primary worker. These aren't insurmountable problems at all. They are really legislative and administrative problems and I would urge that this committee give a concentrated effort in the near term to find a solution to these and the Social Security Administration as well.

Now, as to the specific recommendations that were recommended by the Commission, I would like to briefly describe them to you and the numbers of the individuals they affect.

The first one is really primarily a technical change. It does allow continued benefits for certain widows or widowers. These are all nonsexist recommendations, but the people they affect are primairly women. These are disabled and divorced widows who are already eligible for benefits, already receiving them and the Commission recommends that they should not lose them if they remarry. This change was made in 1977 for widows in general and really due to an oversight in the final law, a provision which had been included the House verion of that law, it has not been applied to disabled widows or to divorced widows. The Commission recommends that it should be so.

I believe the committee will agree and there is no way of knowing the numbers of people that it would affect, because the Social Security Administration does not have data regarding it.

The second one is the ability for divorced spouses to receive that dependent benefit to which they are eligible if the marriage has had a duration of 10 years and if the age eligibility requirements are met if the former spouse has not actualy retired or continues to earn some so that the benefits are reduced.

Again, this has been a problem that has plagued a small number of divorced spouses, but if it does affect them, it is a very serious problem.

Presently, I have found that there are 46,000 divorced spouses receiving benefits. Less than 2,000 at this time are receiving benefits that are reduced because of earnings of the former spouse and there is no data to know how many are not receiving the at all because of the fact that there is no eligiblity of the former spouse.

The third one is a very technical provision and it has to do with the bringing up to date of the work credits for the spouse who died before the widow or widower was older enough to receive benefits. I won't try to spell out the technicalities of that, but it has been done in the past by using wage increases up to 2 years before the time of retirement or age eligibility for receiving these retirements by the spouse and then applying the COLA provisions.

The Commission recommends that the use of wage increases be the factor that is used to bring those work credits up to date. Indeed, it is logical and is especially important in the future in a more normal economic time. Also it is especially important at that time in the future should the stabilizing provision of the COLA recommended by the Commission come into affect.

The fourth is an adequacy measure and the Commission recommends that disabled widows who presently are eligible for benefits at age 50 become eligible for a benefit of 71.5 percent of PIA, the same benefit that widows who are nondisabled are eligible for at age 60 instead of the 50-percent benefit.

Disabled widows are permitted to receive benefits at age 50 because of the problems they face and it seems entirely reasonable that at least they should reserve the same level of benefits that nondisabled benefits receive at age 60.

I find that there are about 113,000 disabled widows receiving benefits. There are approximately 1,000 disabled widowers receiving benefits and approximately 85 percent of these are between the ages of 50 and 59 and would have a slight benefit increase by this recommendation.

It must be very clear to this committee having heard the description of the four specific recommendations that were made that though they were made to address certain severe problems with equity or adequacy, they do not in any way begin to address the entire scope of problems that exists for women beneficiaries. This was very clear to members of the Commission and there was a regret on the part of all of us that there could not be more consideration given to this.

However, I must say, my own feeling is that a change of this nature must be made at the time when there is not a severe financial pressure on the system, because such a change would require a transition period which would have additional costs in addition to any cost that might occur because of the change itself.

It was very clear to me that this change is necessary and it seems to me that it would be an ideal time for this transition period to begin in 1990 when the severe financial pressure of financial pressures for the system is ended at least for a significant period of time.

So I would again urge the members of this committee to make a concentrated effort on these areas of problems caused by sociological change and prepare and bring forward the kind of solution for this problem that is befitting a program that is important to social security to all people in our country. It does serve beneficiaries that are 54 percent women and it has served them well and it can serve them better by a more accurate and fair response to their working lives in the future.

I thank very much the members of the committee for allowing me to use my time on this particular subject. It has been a long interest of mine, as you know, and I believe that the interest is in the membership of the committee to give concentrated attention to it in future years as well.

Thank you, Mr. Chairman. I will be happy to respond to questions.

[The prepared statement follows:]

STATEMENT OF MARTHA KEYS, MEMBER, NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Thank you for the opportunity of presenting testimony to the Committee regarding Social Security. In the past, I have sat among you and labored in these vineyards, but I now wear a different hat—that of a member of the National Commission on Social Security Reform, which has spent a great deal of time during the past 13 months examining the current status of Social Security and needed changes in the immediate and long-term future.

I want to express my support for the report of the Commission and its recommendations. It is my belief that the recommendations were achieved after fair consideration of the interests of today's retirees, workers and employers and tomorrow's retirees, workers and employers. The major components are:

Extension of coverage to all non-profit employees and newly hired federal employees.

Acceleration of the present OASDI tax rate for 1985 to 1984 with a complete offset of the increased tax burden through a refundable tax credit.

Acceleration of a portion of the present OASDI tax rate for 1990 to 1988.

Fair reimbursement to the system for coverage of self-employed persons by increasing their contribution from 1½ times the employee rate (with no business expense allowance) to 2 times the employee rate with ½ of the contribution treated as a business expense.

Recapturing a portion of the benefits paid to retirees with significant amounts of other income—more than $20,000 for an individual and $25,000 for a couple—by requiring ½ of their Social Security benefits to be included in taxable income.

Shifting COLAs to a calendar-year basis, thus delaying in 1983 the payment of the COLA for 6 months.

It is clear that no one of these recommendations by itself would have received majority support of the Commission. Taken together, they constitute a carefully balanced solution to both the short-term financing problem and most of the long-term shortfall, by requiring some sharing by all in the solution. Most important, they preserve the basic tenets of the system, restore its financial strength and reiterate its importance to the American people as a society.

I will not comment on each of the recommendations, but of course, will be happy to respond to questions about them. Instead, I will spend most of this time discussing the problems of many women beneficiaries with respect to Social Security and addressing four specific recommendations made by the Commission.

Because of the scope and urgency of the economic considerations facing Social Security, most of the time of the Commission was quite appropriately consumed addressing these important issues. The assurance of appropriate revenues for the difficult 7-year period ahead is of utmost importance to all current beneficiaries, 19 million women, 13 million men, and 3 million children. Time was not available for full consideration by the Commission of the many problems, and unintended consequences for women beneficiaries, of Social Security. The Commission report and additional supplementary statements express the Commissioners' regrets regarding this omission.

Social Security has indeed given extensive protection to women and men. It currently provides benefits for 91 percent of women over 65 (compared to private pensions which pay benefits to only 10 percent of women over 65). Of those persons presently receiving Social Security, 54 percent are women, 37 percent are men and 9 percent are children. The weighted benefit formula has been especially helpful to women because of their generally lower earnings. However, there has been growing concern in recent years regarding adaptation of the Social Security system to the changed roles of women in society and the economy.

The labor force participation rate by married women has almost doubled in the last 25 years. Over 65 percent of all women aged 20 to 54 are now in the labor force. In addition, the divorce rate has increased significantly. Two decades ago, there was one divorce for every four marriages; in 1976 that rate had risen to one divorce for every two marriages.

Although the majority of working age women are in the labor force, many will receive low returns on their contributions to Social Security because they leave the labor force for periods of full-time homemaking or child-caring. The resultant zero years of earnings will lower the benefits of many so much that the 50 percent dependent benefit for a spouse will be higher than the benefits based on her own earnings record. In 1979, 2.4 million women found that their vested contributions to Social Security brought them no more retirement benefits than they would have received as non-working spouses. In addition, under the current system, a two wage-earner couple receives lower family retirement and survivor benefits than a one wage-earner couple with the same family earnings and contribution history.

Other problems exist for women under Social Security. Homemakers have no individual coverage or eligibility to Social Security and no credits of their own on which to build with later employment occasioned by early widowhood or other reasons. Divorced women are severely affected by the arbitrary 10-year duration-of-marriage requirement and the inadequacy of the 50 percent dependent benefit for their independent economic needs. Currently, the benefit for the divorced woman depends upon the actual retirement of the former spouse; however, the Commission has recommended a change which will eliminate this problem. Disability protection exists only for women who remain quite continuously in the labor force and not at all for homemakers. It is often lost to working women during periods of time spent in the home.

Since 1976, when Representative Don Fraser and I introduced legislation to implement the concept of earnings sharing under Social Security, I have strongly believed this to be the best solution to these anomalies. Earnings sharing is recognition of marriage as an economic partnership with equal respect given to the division of labor chosen by each couple. It accords the right of each individual to a retirement income based on half of the total retirement credits earned by the couple during their marriage. This is much the same as the sharing of income in the joint tax return of a married couple. Working women would have a continuous record of Social Security credits when they retire instead of zero credits for years spent working in the home. Such a record would respond to, and recognize, the economic value to the couple of full-time work in the home by either spouse.

Earnings sharing has been proposed in many forms and was recommended in some form by both the 1979 Advisory Council on Social Security and the 1980 President's Commission on Pension Policy. Obviously, such a comprehensive change in structure requires careful development of a detailed proposal and thorough analysis of its impact. There are many technical and administrative questions to be worked out and special consideration must be given to continued strong protection for the family against death or disablement of its primary wage-earner. These are not insurmountable problems, however; indeed they are legislative and administrative details. They should be given concentrated attention by this committee and the Social Security Administration in the immediate future.

A comprehensive structural change must be implemented with a transition period and should be accomplished at a time when there is not serious financial pressure on the system. Thus, 1990 is an ideal time for such a transition period to begin.

The Commission made four specific recommendations to address certain severe problems for specific, small groups of beneficiaries. Although the impact of these recommendations is small in terms of numbers, they are important changes for those women affected. They are:

1. *Continued benefits for certain widow(er)s who remarry.*—Prior to the Social Security Act Amendment of 1977, the remarriage of a surviving spouse terminated benefits based on the deceased spouse's record, and allowed only a wife's (50 percent) benefit based on the present spouse's record. Effective January, 1979, the situation changed for some surviving spouses. The 1977 amendments provided that remarriage of a currently entitled widow(er), age 60 or over, would not terminate benefits. The final version of the legislation did not (as the House bill had) include a similar provision for divorced surviving spouses and disabled surviving spouses.

The National Commission recommends that remarriage not terminate existing benefits for divorced surviving spouses and disabled surviving spouses who remarry. There is no data presently available regarding the number of beneficiaries affected.

The proposal is estimated to cost $100 million in the short term and to be negligible in the long-term (less than 0.005 percent of payroll).

2. *Independent benefits for divorced spouses.*—Under current law, a divorced woman must wait until her husband retires to receive a benefit. If the former spouse continues to work, his earnings can reduce or terminate her benefit although they no longer live in the same household.

The Commission recommends that spouse benefits for divorced spouses be payable when the divorced spouse reaches age 62 (the age at which eligibility for such benefits normally begins), if the former spouse is otherwise eligible for benefits, whether or not he has actually claimed benefits and regardless of the level of his earnings.

The Commission report adds the suggestion that there be a requirement that the divorce have occurred a significant period before retirement age. I do not share the view, upon which this suggestion apparently rests, that the provision would be an incentive to divorce. However, if the suggestion is adopted, the period should be no longer than one year so as not to impose a hardship on those who are legitimately attempting to finance two households. The cost of the provision would be minimal, approximately $100 million in the short-term and 0.01 percent of payroll in the long-term.

There are presently 46,000 divorced spouses receiving benefits and 1,600 receiving reduced benefits because of earnings of the former spouse. There is no data regarding the number completely ineligible because the former spouse has not applied for benefits.

3. *Indexation of deferred widow(er)s benefits.*—The Commission recommends that the wage record of a spouse, who dies before the widow(er) is old enough to receive benefits, be indexed according to the increases in wages that occurred between the time of the death of the worker and the beginning of benefits to the surviving spouse. This is essentially a technical provision more important for future years of normal economic expectations regarding wage increases.

4. *Disabled widow(er)s benefit.*—Under current law, reduced benefits for surviving spouses without dependent children are available at age 60-64 in the amount of 71.5 percent of the Primary Insurance Amount. Benefits are 100 percent of the PIA for surviving spouses collecting benefits at age 65 or over. Disabled widow(er)s are eligible for reduced benefits at age 50-59 in the amount of 50 percent of the PIA.

The National Commission recommends that the benefits rate for disabled widow(er)s age 50-59 should be the same as those for non-disabled widow(er)s at age 60-71.5 percent of PIA.

This proposal would cost $1 billion in the short-term but would represent a modest cost of 0.01 percent of payroll in the long-term.

There are currently 113,000 disabled widows receiving benefits and 1,000 disabled widowers. Approximately, 29 percent of these are between the ages of 50-54 and 55 percent are between the ages of 55-59. Thus, the benefits would be raised for approximately 84 percent of these current beneficiaries.

These changes were recommended by the Commission because they clearly address the equity or adequacy of certain—primarily women—beneficiaries with severe problems. I hope that it is clear to members of the Committee, as it was to members of the Commission, that these changes do not begin to address the wide range of equity and adequacy problems for women beneficiaries. I believe that the members of this Committee will carry out that responsibliity.

Chairman ROSTENKOWSKI. Well, thank you very much, Ms. Keys. It has been rewarding to have you participate and to give us your views.

Mr. Conable?

Mr. CONABLE. Mr. Chairman, I would like to confirm the total worthiness of the equity positions that Martha got into on the report of the Commission. She took the initiative on it. There were appropriate changes. I would like also to confirm what she says about the need for further equity with respect to working women. Our difficulty there is the very difficulty that we have been laboring with early this morning—the feeling that any change in the formula is a reduction of benefits because, quite frankly, being under the fiscal pressure we are under, it would not be possible to go to income splitting without taking something away from some of the current beneficiaries in terms of their eligibility for disability or in terms of their long-term social security benefits if they and their wives or their spouses made less than the maximum.

It is a very difficult subject to deal with and it demonstrates, quite clearly, what a bad instrumentality of change government institutions are generally. That we should have a social security system which reflects the work force of 1935 and not the work force of today is a disgrace, but it reflects the rigidity almost inherent in public institutions in which people have vested interests.

We have to deal with this problem because it is not fair to have the kinds of provisions based on social adequacy which, in fact, mean that most working women get nothing back in return for their contributions to the system over what they would have if they had stayed home and not worked at all. Women are working nowadays whether we like it or not and I happen to like it. And they ought to be recognized by a more flexible system than we seem to be able to generate in this terribly central and important area of retirement.

If you have any comments on that, Martha, I would be glad to hear them.

Ms. KEYS. I appreciate your concern on it. We have certainly shared those for a long time. My own feeling is that you can't have comprehensive change in this system which has always had to be fine-tuned for financial, demographic or societal changes. You cannot accomplish a comprehensive change for the purposes of society change at the time when you have strong financial pressures on the system.

I don't share the despair that some feel at this moment that this Commission was unable to make larger, more comprehensive recommendations because I think it is impossible at this time.

But I do believe the ideal time is ahead of us a very few years hence and I think it is time that both the Congress and the Social Security Administration get on with it.

I picked up a magazine on the airplane yesterday and it was an article referring to trends of the future both in society and the economy and it had a comment to make which applies to this situation in which it defined the numbers of traditional family, male breadwinner, female at home and children in the home as being only 7 percent of our society.

There is some disagreement but I would think no one would argue that it is less than 17 percent. I imagine that would be somewhat true. We have to make this system respond to the facts of our society and really treat with equal respect the choice of each married couple as to the division of work in behalf of the interest of that family and home.

Chairman ROSTENKOWSKI. Mr. Pickle?

Mr. PICKLE. I welcome Ms. Keys back with our committee. She was a great member of this committee and a great member of this Commission.

I agree that the suggestions made with respect to women are timely and appropriate. As chairman of the social security committee I realize there is a great deal more action to be taken. We are mindful of that and we will be looking at that in the future.

Ms. KEYS. Thank you.

Mr. Jacobs. Mr. Chairman, I thank the gentlelady for her service on the Commission, too, without compensation, I understand.

I just wanted to say for the record that I commend the gentleman from New York for his remarks on community property division between married couples, it is something that is pretty well established in this society. The problem is that the social security system hasn't gotten word yet and I am happy to see the support expressed by two senior members of the committee already and I am sure it reflects the attitudes of most of the members of this committee.

Ms. Keys. I thank you, gentlemen.

Chairman Rostenkowski. Mr. Gibbons.

Mr. Gibbons. Martha, first of all, I want to welcome you back. You always made so much good sense while you were here and I know the fine work that you are doing now that you are not here.

I realize that we meet today, for the rest of this month and perhaps for the rest of the next 3 months to make a major short-range repair job in the system we have and I am very interested in the views that you have expressed and that Congressman Conable expressed.

Has any work been done to determime what increase in cost this would amount to as far as payroll tax is concerned?

Ms. Keys. There are many different earnings sharing proposals that have been noted in the past years and they have had financial costs ranging all the way from 0.06 percent of long-term payroll to 0.36 percent. Basically new costs come from new benefits whether or not you include disability coverage for homemakers which would be really extending a new benefit that doesn't exist in the system today.

If you include that new kind of benefit coverage which many feel you should, that is a significant element of cost.

The other significant element of cost largely comes from the transition period and from the grandfathering in present levels—for instance, the one-wage-earner couple with its present level of retirement benefits and survivor benefits that is higher than the two-wage-earner couple which are the majority.

But, again, it depends on how far you go. It depends upon the technicalities. There was a modified earnings sharing proposal that was given a great deal of consideration by the 1979 Advisory Council which really met most of the technical problems with preserving family protection in case of early death or disablement and it had a cost of 0.12 percent of payroll.

So, it really gets down to negotiation on a number of items to produce the kind of continued protections that you want and a decision about granting new disability protection to a large new number of people.

Chairman Rostenkowski. Mr. Guarini?

Mr. Guarini. I thank you very much for the important contribution you have made in bringing out the inequities and inadequacies of the system. Many of them were quite apparent to people for an extended period of time.

I am just wondering whether or not in order not to lose the momentum if there is any language that should be put in the report so that we could find a mechanism of continuing the study and that we could address ourselves to this problem in the future.

To let it drop here I think would be losing some of the important contributions that have been made. Do you have any suggestion as to how we could continue to pursue this matter, Martha?

Ms. KEYS. Well, I certainly think that the interest of members of this committee and devotion of the time and effort of the committee and their staff is an important step in that direction.

The same kind of support involvement needs to come from the Social Security Administration. I would hope that might be there. The report of the Commission, both in the language of the report itself as well as in supplementary statements signed by four other Commissioners and myself and some other statements put in by other Commissioners do specify and refer to this problem.

So I do think that your continued interest is the most important. I thank the gentleman for expressing it.

Chairman ROSTENKOWSKI. Mr. Hance?

Mr. HANCE. Martha, I, too, say thank you for your service on the Commission, especially as to earnings sharings. That concept comes from community property law which has worked extremely well in many States, especially my home State, and has been one of the areas that I think, as far as equality is concerned, Texas has been out front on for many years but there is still a long way to go.

This is just another example, like the divorced military spouses legislation we had last year, of legislation that is needed and is long overdue. I appreciate your mentioning this problem and I will work with you in trying to solve it.

Chairman ROSTENKOWSKI. Mr. Matsui.

Mr. MATSUI. Martha, I also would like to thank you for your contribution to the Commission's work and your testimony today.

I share Frank Guarini's concern that once we solve both the current and the long-term problems associated with social security, we shall not want to revisit the issue in the near term.

I agree that the Congress eventually should make those necessary changes that are required to protect both working and nonworking women.

We shall continue to work with you.

Ms. KEYS. I would just like to respond by reminding the gentleman that though financial pressures always are felt more keenly than other pressures that the pressures of societal change and a system truly serving that society ought to be just as strong and ought to be dealt with at a time when the financial pressures are less.

So I would just urge you to keep that in mind every time you think with despair about going into the subject again.

Chairman ROSTENKOWSKI. Mrs. Kennelly.

Mrs. KENNELLY. Ms. Keys, yesterday we heard Alan Greenspan, your chairman, and other members of the Commission advocate advancing the retirement age to 66. Today you referred back to that same position. Yet, when I see the latest figures coming from the Social Security Administration, I see that almost 60 percent of the women who are retiring are retiring early, whereas, less than 50 percent of the men are retiring early.

If you add widows and spouses to these figures, a huge percentage of those retiring early are women.

Did the Commission discuss the fact that raising the retirement age from 65 to 66 would be particularly harsh on women? Isn't this an aspect of the problem women have with social security that we can talk about now rather than waiting for some future time?

Ms. KEYS. There was certainly some discussion of that. I do not agree with the proposal of raising the retirement age and my remarks joining with four other members of the Commission in the end show my preference that we should wait until 2010 and then if it is needed impose instead additional tax on the employer and the employee.

I think it is a far preferable solution. It is very clear that women who have suffered institutional discrimination in employment all through their lifespan have far more discrimination at older ages.

I believe the percentage of working women over 65 or over 62 even is very low. It is in the single digits. The jobs are not there for them. So I think now with 11 million people of working age unemployed it is rather ridiculous to think that merely delaying the retirement age would allow people to continue to work at a later age.

And, indeed, even those who are recommending the increase in retirement age are recommending it for some time in the future. That is true. But I just do not see any statistics or facts that make me agree that this is a solution for anyone and it certainly is very punitive for women because there just aren't jobs for them.

Again, the earlier mentioned problems for homemakers who do not have sufficient history of work credits to build upon when they are forced through early widowhood to look to the work force for income, these problems are compounded for women when you think of increasing the age for retirement benefits.

It is certainly one of the reasons that I have always strongly opposed such a change.

Mrs. KENNELLY. Thank you.

Chairman ROSTENKOWSKI. Are there any further questions?

If not, thank you very much, Ms. Keys.

Ms. KEYS. Thank you very much, Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Kirkland, welcome to the committee. As usual we are not only impressed with your presence but your observations. I want to express our gratitude for your participation in the Commission and for helping mold the report which was ultimately submitted to the President.

Lane, if you are ready to make your statement we are ready to receive it.

STATEMENT OF LANE KIRKLAND, PRESIDENT, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS, AND A MEMBER OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Mr. KIRKLAND. Thank you, Mr. Chairman.

By your leave I would like to introduce my complete statement.

Chairman ROSTENKOWSKI. Without objection, your entire statement will be included in the record.

Mr. **Kirkland**. I will deal with particular points in the statement.

Mr. Chairman, in an effort to reach agreement, the Democratic members of the Commission reluctantly made concessions from deeply held positions, but a bipartisan agreement insuring the financial stability of social security based on relatively modest adjustments was preferable to the drastic benefit reductions some have advocated.

The bipartisan compromise solution will solve the system's short-run problems between now and 1990 and will keep the system solvent for at least 75 years without any significant reduction in benefits.

One item in the consensus recommendations which I reluctantly accepted is the one-time 6-month delay in the annual cost-of-living adjustment. Fortunately, the lower rate of growth in the Consumer Price Index in 1982 means the delayed increase will be the lowest of many years.

In addition, the poorest beneficiaries will be given compensating increases in their supplemental security income benefits.

The 6-month delay was crucial to the consensus agreement and had to be weighed against the possibility of even more serious benefit cuts without it.

As I have said, there is one Commission proposal which I could not accept. I refer to the recommendation for mandatory social security coverage of newly hired Federal and postal employees.

The proposal is being put forward in the context of seeking more funds to help finance the social security system and not in the context of what is best for Federal and postal employees.

In effect, these employees are being asked to blindly accept an unknown proposal.

No such proposal should be put forth until its details are known and Federal employee representatives have had an opportunity to evlauate and comment on it.

The AFL-CIO will oppose any proposal for mandatory coverage of Federal, postal, State and local government employees unless it meets the following criteria: (1) No reduction in the level of pension benefits now available to such workers; (2) no additional financial burden imposed on employees without a commensurate adjustment in benefits; (3) maintenance of the identity of their retirement plans; (4) no diminution in the opportunity for these employees to improve their retirement systems.

I support the Commission recommendation that would remove the option for State and local governments to withdraw from social security once they have elected coverage.

Once coverage is elected, withdrawal should not be allowed. At the same time, provision should be made to permit withdrawn employers to reenter the system and to specify ways for workers and/or their unions to initiate such action.

An excellent substitute source of revenue to more than replace the revenue that would be gained by covering newly hired Federal employees would be to tax the full payroll of employers as was recommended by the Carter administration.

The employer portion of the tax is based on the assumption that the employer has a responsibility for paying not only wages but also a deferred wage to help maintain workers and their families when their working days are ended. It plays no role in detemining the amount of the worker's benefit and there is no logic in not applying it to the total payroll.

My proposal would increase the system's income by about $40 billion by 1990 and reduce its long-run deficit by 0.56 percent of taxable payroll.

The responsibility of employers for the welfare of their employees should be related to their total payroll rather than to just a part of each employee's earnings.

In many countries, employers either pay social security contributions on the total earnings of employees or their social security taxes are larger than the employee's taxes.

As you know, Mr. Chairman, the consensus recommendations cover full the Commission's projected short-term deficit but also two-thirds of its projected long-term deficit.

Both the Democratic and Republican appointed Commission members recommended that additional measures be taken to deal with the total projected long-run deficit.

We could not agree on a mutually acceptable way to handle the problem but each side agreed to submit supplemental statements on how to achieve the objective.

The Democratic-appointed members, those selected by the Democratic leadership of the Congress, recommend increasing the employer and employee contribution rate in 2010 by 0.46 percent of taxable payroll, the employee increase would be offset by a refundable tax credit. I support this recommendation.

It is important for public confidence to show a 75-year actuarial balance by setting a tax rate in the next century that would fully finance the program. But this should be done on the understanding that such a tax rate based on so many volatile assumptions so far in the future will undoubtedly have to be adjusted at some future time and may never take place.

The majority proposal, consisting entirely of members appointed by the President and the Republican leadership in Congress, would raise the retirement age by a month each year, beginning in the year 2000 so that it would reach 66 in the year 2015.

After that, the retirement age would rise in accordance with life expectancy and would be based on the principle of a constant proportion of adult life in retirement.

In my view, this is a bad proposal. Raising the age of eligibility is not different from an across-the-board benefit reduction. While this proposal would still allow paying benefits at age 62, it would result in an increased actuarial reduction starting at that age.

Moreover, the proposed benefit cut, for that is what it is, would be at the expense of some of the poorest and most deprived of our older citizens—those forced out of the labor market because of health conditions or unemployment.

Though it is true that on the average, older people will be living longer in the future, there would be many, probably most as is now the case, who would have to give up their jobs before being eligible for full benefits.

Two experts on aging testified before the National Commission that increased longevity does not mean a commensurate improvement in health. If anything, the limited evidence available seems to indicate the opposite—more people living longer but with more disabilities.

In short, medical science is keeping people alive longer, but that includes chemotherapy, pacemakers, and kidney dialysis, which do much to extend life but very little to extend work life.

Raising the age of eligibility for full retirement benefits would place an unequal burden on the majority of workers who are forced to leave the labor market because of poor health or inability to find a suitable job.

It is simply wrong to decide now to extend the retirement age in the future when there is no assurance that employment opportunities or health conditions of the elderly will be significantly improved.

In conclusion, Mr. Chairman, I am certain that the Congress will act to insure that the consensus essential to the passage of sound social security legislation will be achieved. To that end, the AFL-CIO will endeavor to play a constructive role in insuring the solvency of the social security system.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF LANE KIRKLAND, PRESIDENT, AMERICAN FEDERATION OF LABOR & CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. Chairman, I appreciate the opportunity to present my views on proposals for financing the social security system. Social security is the foundation of American social policy. Given the importance of the program to workers, active and retired, I felt an obligation to accept appointment to the National Commission on Social Security Reform (NCSSR). I support all but one of its consensus recommendations because they are reasonable and because they offer the best opportunity to make the program secure for present retirees and future generations of workers.

In 1935, the American people, under the enlightened leadership of Franklin D. Roosevelt, made a commitment to the nation's elderly and to each succeeding generation of older people. Forty-eight years after its enactment, many have forgotten what life in the United States was like for the elderly before social security, and many young Americans have little understanding of the impact this program has had on our way of life.

Before social security, retirement for the vast majority of Americans meant dwindling savings and increasing dependency on family and neighbors. To many it was a frightening experience of destitution, dependencey and private charity. It was a time when the phrase "Poor House" referred to real places where the elderly poor could expect bare subsistence and an accompanying loss of respect as well as personal degradation.

The fact that this bleak picture has improved so much is due primarily to social security. It has done more than any other American institution to provide our elderly citizens economic security and dignity. But social security is more than retirement or pensions. It provides a guaranteed income for the spouse and children when a younger worker dies and the same sort of income in the event of his or her total disability. These safeguards are not for those retired but for those still at work.

Mr. Chairman, in an effort to reach agreement, the Democratic-appointed members of the Commission reluctantly made concessions from deeply held positions. But a bi-partisan agreement insuring the financial stability of social security based on relatively modest adjustments was preferable to the drastic benefit reductions some have advocated. The bi-partisan compromise solutions will solve the system's short-run problems between now and 1990 and will keep the system solvent for at least 75 years without any significant reduction in benefits. Workers and beneficiaries can feel secure for now and the foreseeable future.

One item in the consensus recommendations which I reluctantly accepted is the one-time six-month delay in the annual cost-of-living adjustment. Fortunately, the lower rate of growth in the Consumer Price Index in 1982 means the delayed increase will be the lowest of many years. In addition, the poorest beneficiaries will be given compensating increases in their Supplemental Security Income (SSI) benefits. The six-month delay was crucial to the consensus agreement and had to be weighted against the possibility of even more serious benefit cuts without it.

This agreement will avoid the dangers of a protracted political battle in the Congress and the risk of major benefit cuts, adoption of unsound proposals and temporary band-aid financing. Without this agreement, there would have been a further loss in public confidence and a sensible, permanent solution would have been made more difficult or even impossible.

Not just the Commission's consensus recommendations, but equally important, its unanimous agreement on the program's fundamental soundness and support for the principles on which it is based, should put to rest social security bankruptcy scare stories. Given the political composition of the members of the Commission, their unanimous affirmation of support for the program should go a long way toward restoring public confidence.

As I have said, there is one Commission proposal which I could not accept. I refer to the recommendation for mandatory social security coverage of newly hired federal and postal employees. The proposal is being put forward in the context of seeking more funds to help finance the social security system and not in the context of what is best for federal and postal employees. In effect, these employees are being asked to blindly accept an unknown proposal.

No such proposal should be put forth until its details are known and federal employee representatives have had an opportunity to evaluate and comment on it. The AFL-CIO will oppose any proposal for mandatory coverage of federal, postal, state and local government employees unless it meets the following criteria: (1) No reduction in the level of pension benefits now available to such workers; (2) no additional financial burden imposed on employees without a commensurate adjustment in benefits, (3) maintenance of the identity of their retirement plans, (4) no diminution in the opportunity for these employees to improve their retirement systems.

I support the Commission recommendation that would remove the option for state and local governments to withdraw from social security once they have elected coverage. Unlike private employers and employees, state and local government employees are covered on an elective basis and these public employers can unilaterally withdraw from the program. When they do, their employees lose valuable protections. Once coverage is elected, withdrawal should not be allowed. At the same time, provisions should be made to permit withdrawn employers to reenter the system and to specify ways for workers and/or their unions to initiate such action.

The AFL-CIO is particularly concerned about the widespread withdrawals from social security by hospitals and other nonprofit institutions and the consequent loss of many empoyee benefits. I support the Commission's recommendation for mandatory coverage of nonprofit institutions as the best way to correct the problem and to restore lost benefits.

An excellent substitute source of revenue to more than replace the revenue that would be gained by covering newly hired federal employees would be to tax the full payroll of employers as was recommended by the Carter Administration. The employer portion of the tax is based on the assumption that the employer has a responsibility for paying not only wages but also a deferred wage to help maintain workers and their families when their working days are ended. It plays no role in determining the amount of the worker's benefit and there is no logic in not applying it to the total payroll. My proposal would increase the system's income by about $40 billion by 1990 and reduce its long-run deficit by 0.56 percent of taxable payroll.

The responsibility of employers for the welfare of their employees shoud be related to their total payroll rather than to just a part of each employee's earnings. In many countries, employers either pay social security contributions on the total earnings of employees or their social security taxes are larger than the employee's taxes. In addition, the U.S. employer tax is actually less than the employee's because it is deductible as a business expense from the employer's income tax.

Acceleration of payroll taxes

The consensus recommendations accelerate tax increases already scheduled in present law but avoid any new payroll taxes. The 1985 rate increase of 0.3 of a percent would be moved forward one year and workers would be provided a refundable tax credit for the amount of the increase. The 1990 scheduled increase (0.5) would be partially moved forward (0.34) for the years 1988-89. Thus, workers will bear no new additional tax burden for five years, and the additional burden will consist of a partial two year acceleration of an already scheduled tax increase.

The consensus recommendations on payroll taxes will have no impact on the present recession or unemployment contrary to exaggerated statements being made.

The 1984 tax advance would be totally offset by a refundable tax credit. Payroll tax increases or benefit reductions of equivalent amounts produce approximately the same restrictive economic results. In any event, the effects of either can be offset partially or wholly by monetary policy. It is reasonable to expect the Federal Reserve will modify economic policy to take account of future tax increases, particularly since the effect of these increases will be to reduce the budget deficit. Thus, the claims that the Commission's recommendations on payroll taxes will increase unemployment are inaccurate and based on faulty analysis.

The much worse than expected performance of the economy is the cause of social security's short-run funding problem. First, much greater than projected inflation rates have triggered higher cost-of-living benefit increases while persistent restriction of wage increases has held down the revenue of the system. Second, much higher than expected unemployment rates have also curtailed expected revenues. In short, benefit costs are more and revenue less than were estimated. Social security's serious financing problems between now and 1990 are due to the sad performance of the economy resulting largely from the policies of the Reagan Administration. If we can get the economy moving again, some of the payroll tax increases now scheduled may not be necessary.

Social security and women

The various provisions of the Social Security Act relating to the treatment of men and women can be divided into two categories: those that contain specific reference to sex for the deliberate purpose of treating men and women differently; and those that make no specific reference to sex but indirectly result in differing treatment of men and women because of economic and social security extraneous to the law.

With regard to the first, the AFL-CIO has long taken the position that the same legal rights in all respects should flow from a worker's wage regardless of whether that worker is male or female. The second category is much more complex to deal with for it is difficult to correct by modifications in the Social Security Act the socioeconomic imbalances that have arisen for reasons unrelated to social security.

Nevertheless, changes are needed in social security to deal more equitably with the benefit problems associated with women. The program was founded on the then prevailing social and economic patterns—men were largely the bread-winners and women for the most part were to receive benefits as wives and widows. Though the Social Security Law, with minor exceptions, treats equally men and women with the same work and earnings record, the basic structure of the program is not fully suitable for current work and family patterns which are characterized by the movement of women in and out of the labor force and increased divorce rates.

The Commission did recommend a number of significant changes primarily aimed at improving protection for certain groups of widows, divorced women and disabled women. I regret that because of the limited time and the overriding need to deal with the program's financing problems, the Commission was unable to give the women's issues more extensive consideration. At the earliest possible opportunity the Congress should deal with these issues in a more comprehensive fashion.

Long-run solution

As you know, Mr. Chairman, the consensus recommendations cover fully the Commission's projected short-term deficit but also two-thirds of its projected long-term deficit. Both the Democratic- and Republican-appointed Commission members recommended that additional measures be taken to deal with the total projected long-run deficit. We could not agree on a mutually acceptable way to handle the problem but each side agreed to submit supplemental statements on how to achieve the objective.

The Democratic-appointed members (those selected by the Democratic leadership of the Congress) recommend increasing the employer and employee contribution rate in 2010 by 0.46 percent of taxable payroll (the employee increase would be offset by a refundable tax credit). I support this recommendation. If the Congress were to adopt the AFL-CIO suggestion to tax the full employer payroll instead of accepting the Commission's recommendation to cover new federal and postal employees, the increase would have to be only about 0.16 percent.

It is important for public confidence to show a 75 year actuarial balance by setting a tax rate in the next century that would fully finance the program. But this should be done on the understanding that such a tax rate based on so many volatile assumptions so far in the future will undoubtedly have to be adjusted at some future time and may never take place.

Among the nations of the world, only the United States and Canada attempt to project the cost of their social insurance system for 75 years into the future and only three others for as long as 50 years. Other nations feel that such projections are neither reliable nor useful. Very small differences in economic, demographic and other assumptions can lead to great variations in estimating the long term costs of a social security program when compounded over 75 years.

The majority proposal (consisting entirely of members appointed by the President and the Republican leadership in Congress) would raise the retirement age by a month each year, beginning in the year 2000 so that it would reach 66 in the year 2015. After that, the retirement age would rise in accordance with life expectancy and would be based on the principle of a constant proportion of adult life in retirement.

This is a bad proposal. Raising the age of eligibility is not different from an across-the-board benefit reduction. While this proposal would still allow paying benefits at age 62, it would result in an increased actuarial reduction starting at that age.

The proposal would break faith with young workers. They would be the ones affected by the future increases in the age of eligibility and, adding insult to injury, would also be required to pay larger social security contributions over their working lives. This would undermine confidence in the system.

Moreover, the proposed benefit cut, for that is what it is, would be at the expense of some of the poorest and most deprived of our older citizens—those forced out of the labor market because of health conditions or unemployment. Though it is true that on the average, older people will be living longer in the future, there may be many, probably most as is now the case, who would have to give up their jobs before being eligible for full benefits.

Two experts on aging testified before the National Commission that increased longevity does not mean a commensurate improvement in health. If anything, the limited evidence available seems to indicate the opposite—more people living longer but with more disabilities.

In short, medical science is keeping people alive longer, but that includes chemotherapy, pacemakers, and kidney dialysis, which do much to extend life buy very little to extend work life. Raising the age of eligibility for full retirement benefits would place an unequal burden on the majority of workers who are forced to leave the labor market because of poor health or inability to find a suitable job. It is simply wrong to decide now to extend the retirement age in the future when there is no assurance that employment opportunities or health conditions of the elderly will be significantly improved.

We should remove barriers that stand between older workers and employment and pursue effective economic policies that enable people to work. This would result in voluntary decisions to work by those who can without taking benefits from those who can't. Under these conditions, the delayed retirement incentives recommended by the Commission will work. We should rely on incentives rather than coercion.

The proposal of the Republican-appointed members to raise the retirement age would have an immediate impact on private pensions. Actuaries must estimate funding requirements 25 and 30 years into the future. The proposal begins to phase-in the increased retirement age in the year 2000, only 17 years from now. If inacted into law, this proposal would force many private plans to modify their provisions—either to cut benefits or increase funding. Employers would have to absorb these increased costs or reduce their private pension obligations.

The proponents of the proposal have not produced any estimates on what benefit reductions might result. They cannot argue that if future economic performance is better than expected but unemployment and health conditions of older workers not significantly improved, Congress can repeal the increase in the retirement age. There will be no easy repeal of a decision that was taken years earlier for private pension plans will already have made their adjustments.

Let's look back 17 years—the time period equaling the future time span before the effective date of the majority's recommendation. The inflation rate in 1966 was 2.9 percent and unemployment rate 3.8 percent. A major focus of discussion among economists in 1966 was how to spend the fiscal dividend—the excess federal revenues then developing from favorable economic conditions. Both politicians and economists were making optimistic statements about solving the problems of the poor without inconveniencing the rich. No one foresaw the economic mess in 1983—17 years into the future.

Fortunately, the Congress of that day did not pass legislation intended to influence present day economic and social policy. Nor should this Congress legislate in a way that could create problems for a future Congress. I urge this Committee to reject the majority proposal for resolving the long-run financing problem and to support the recommendation of the members selected by the Democratic leadership in the Congress.

In conclusion, Mr. Chairman, I am certain that American workers can have every confidence that this Committee and the Congress will act to insure that a consensus essential to the passage of sound social security legislation will be achieved. To that end, the AFL-CIO will play a constructive role in insuring the solvency of the social security system.

Chairman ROSTENKOWSKI. Thank you, Mr. Kirkland.

We certainly recognize the fragile coalition that has been put together and we are mindful of the fact that in the legislative process we are going to have to be constantly aware of that.

I am hoping, though, that ultimately we will be able to come to some conclusion. I think there is a great consensus here about the short term but I hope we can come to some favorable conclusion in the long term.

Any questions of Mr. Kirkland?

Mr. Conable?

Mr. CONABLE. Only to thank him again for his contribution to the compromise that was finally worked out.

It was a difficult compromise to achieve. Everybody had to give and the gentleman participated in a way entirely appropriate to the fine reputation that he has as a leader of the labor movement.

Mr. KIRKLAND. Thank you, Mr. Conable.

I enjoyed very much working with you on that Commission and admired your positions and the integrity of your views.

Mr. GUARINI. Mr. Kirkland, thank you very much for your testimony and your great contribution to the Commission.

Many countries have different ages of retirement where they would distinguish between farm, industrial, and perhaps service professions, et cetera.

Did your Commission give any thought to that? Because we know people are going to live longer and in certain types of businesses people do work longer as a matter of practice.

There are statistics on that. Rather than generically handling everybody at the same retirement age, do you think there should be any distinguishing?

Mr. KIRKLAND. Well, there is to some extent in this country. I am thinking particularly of plans that cover some groups of workers engaged particularly in strenuous or hazardous employment such as policemen and firefighters who usually have a lower retirement age. We have over the past few years, in collective negotiations and private pension systems that emerge from collective bargaining, made adjustments and changes in the age of eligiblility for retirement which in more and more cases provide for earlier eligibility than the 65 in social security.

For example, in some of the more recent industrial plans the eligibility is governed by the proposition of 30 and out. If you work 30 years you are entitled to retire at the normal benefit irrespective of age. The trend has been to, in private pension systems negotiated, to reduce the retirement age. That is to advance the age at which people have the option to retire and engage in pursuits that they might elect to follow rather than working for someone else.

That is one of the factors that weighs very heavily in our conclusion that it would be an error to proceed in the opposite direction with respect to the social security system.

It would increase the difficulty of meshing the realities of the private pension systems that are supplemental to social security with the social security system and would transfer, inevitably, it would not spare employers who contribute to those private systems any cost but would simply transfer that cost to the private system because I cannot conceive that there will be, and I see no signs of any inclination for those systems to begin increasing their retirement age.

Chairman ROSTENKOWSKI. Mr. Matsui?

Mr. MATSUI. Thank you, Mr. Chairman.

Mr. Kirkland, in your opinion, how important is it for the Congress to solve not only the short-term problem by the proposal presented by the Commission, but also the long-term problem?

Mr. Greenspan yesterday indicated that it was very important for us to resolve both aspects of the problem.

Mr. KIRKLAND. I believe that it is important that we deal with both aspects of the problem insofar as we are able to perceive them in any realistic terms. I do believe that it is very important to strengthen public confidence in the long-range stability of the system as best you can be given the limitations of human foresight or the validity of the figures on which you project the future that far in advance.

I think it can't be viewed as absolute gospel. There are assumptions based on probabilities as far as we can see them now but I do think we need to keep in mind the limitations and the clouds that surround our crystal balls.

Mr. MATSUI. If we do attempt to solve a long-term problem and I think there probably is a consensus to deal with it, would you support the comments made yesterday by witnesses that they would accept whatever alternative we finally recommended, notwithstanding their own preferences?

For example, Dr. Greenspan indicated that he did not want to increase taxes in the year 2015. He would prefer an increase in the age of retirement. But to resolve the long-term problem he would accept whatever consensus was reached by the Congress.

Would you endorse any final legislative recommendation as long as it was within the confines of the options presented to us by the Commission?

Mr. KIRKLAND. Well, sir, I presume that if the Senate Finance Committee and the House Ways and Means Committee reach such a conclusion in conference I would have no choice.

Mr. MATSUI. But your support or opposition will be of significance, especially on the floor as we get closer to final passage. Your comments please.

Mr. KIRKLAND. Well, I think we certainly will do whatever we can in terms of expressing our support for the consensus portion of the report as we did on the Commission with my one reservation on coverage and we would assert as vigorously as we know how as long as an opportunity presents itself a preference for dealing with the residual shortfall and long-term financing through the method that we of the minority on the Commission advocated.

But when you finally take action we live in a democratic country and we will swallow it.

Mr. MATSUI. Thank you.

Chairman ROSTENKOWSKI. Mr. Pease?

Mr. PEASE. Thank you, Mr. Chairman.

Mr. Kirkland, I want to get clear your position regarding the inclusion of Federal employees under social security. You demurred from the Commission report in that respect but even with the inclusion of that you did support the Commission package; is that correct?

Mr. KIRKLAND. I filed a dissent on the issue of extension of coverage to Federal employees. You will find it in the statement.

Mr. PEASE. At this point if the Congress were to adopt the Commission recommendations exactly as submitted, would you recommend a yes vote?

Mr. KIRKLAND. I don't think that you achieve the legislative purpose if you adopt the Commission report with respect to coverage because it does not describe or define the terms of the plan that will be put into place for new employees.

I don't know what that is. We have the position that I have taken that it is expressed in my one-man dissent on this issue of four criteria that we will be strongly advocating and that would govern our view of it.

If those criteria are met, and I think they are reasonable criteria, logical criteria, and ought to be capable of being met, we would certainly support it but I would not want here scuttled my right to exercise every means of persuasion that I can conjure up to bring that question to a happy conclusion.

Mr. PEASE. Mr. Kirkland, I agree with your concerns and that is one part of the package that concerns me the most also.

I think your four criteria are reasonable, ought to be adopted. I would like to see them adopted before we put Federal employees under social security and not afterwards.

I mentioned that concern yesterday to Mr. Greenspan and he said that he could not imagine in his wildest dreams that Congress would not, in due course, before next January, and that supplementary Federal pension system for new hires were put under social security.

I told him I was not quite that sanguine about it. I could imagine it. What is your evaluation of that?

Mr. KIRKLAND. Well, the entire basis for my position, as I stated it at the Commission meetings, is that I thought it was: (a) unfortunate that Federal employees were asked to accept such a proposition in the context of an effort to find more funds to strengthen the social security system.

That was a rather unfortunate context to be raising the issue of Federal employee coverage in. It ought to be dealt with on its merits independent of using it as a source of funding to meet a shortfall in OSI.

Second, I simply did not believe that these employees should be expected or asked to buy a pig in a poke. A vaguely defined program without any specifics about the character of it. In that regard these criteria, I think, are to me governing.

Mr. PEASE. Thank you very much.

Chairman ROSTENKOWSKI. Mr. Martin.

Mr. MARTIN. Thank you very much. I am sure you are intrigued and flattered by the interest of this committee in obtaining your permission and approval before we vote for this package coming from the Social Security Commission.

Aside from the commitment that you made to the compromise in principle, I understand you oppose the coverage for Federal and Postal employees, and would prefer, if you had your druthers, to leave their relationship to social security essentially as it is today. That is, they may elect to stay out of it until such time as they want to participate later in their careers or by qualification through a spouse who works in the private sector; in other words, it is voluntary for them.

Do you also advocate that it be made equally voluntary for private sector employees?

Mr. **Kirkland**. Certainly not.

You will find in the Commission report a reference to the fact that some of these what we regard as rather extreme proposals, such as introducing a means test or making the system "voluntary" were examined and not accepted by any member of the Commission.

Mr. **Martin**. You are saying for most Americans it should be mandatory, but for a few, that is, those who work for the Federal Government and Postal employees, it should remain voluntary, and they should be given that special dispensation so they could elect the time at which they choose to participate or not participate?

Mr. **Kirkland**. That was not my position. You will find it stated in my dissenting report. The basis of my position was that this matter ought to be examined in the context other than using the question of extended coverage as a means of making up a shortfall in the OSI system, and, secondly, that the exact dimensions and nature of the alternative or substitute program that would be put in place supplemental to social security ought to be known in its details, and the representatives of those employees ought to have a full opportunity to participate in the development of it, and that it ought to meet these criteria that I have stated; that is, the net combined result should not diminish retirement benefits which they now enjoy.

Mr. **Martin**. I am trying to put it in a context, other than balancing the social security fund; that is, to place it in the context of what is fair.

I gather you are inclined to think that the question of voluntary participation by Federal and Postal employees does need to be corrected, because you agree that it is unfair for them to be able to have voluntary access to the program without allowing other employees the same privilege. Is that correct?

Mr. **Kirkland**. What I have said, sir, if a plan could be put forward that meets the full criteria, we would regard it as fair, but I think that one should see that—see the terms of it—before you embrace it.

Mr. **Martin**. Well, one of the terms in the proposal raises the idea of what would be the fair thing to do with those Federal and Postal employees who are already employed by the Government and the Postal Service, and who will not be brought under this moderate increase in universal coverage. What it concedes there is that inasmuch as they would later be able to buy into the system to participate just in the last 8 or 10 years of their career, that it would, therefore, reduce the windfall bargain benefit that they would get by later on electing to participate.

Do you support that change?

Mr. KIRKLAND. I supported the elimination of the windfall accrual.

Mr. MARTIN. Fine, because it does show there is an inequity involving Federal employees.

Mr. KIRKLAND. That was under the consensus part that I supported, sir. The part that I took exception to was the ill-defined and broadly-stated coverage of Federal employees.

Mr. MARTIN. Yes, that is why I am trying to bring that from you. You agree there was an inequity that did need to be corrected.

Chairman ROSTENKOWSKI. Mr. Jenkins?

Mr. JENKINS. Mr. Kirkland, one thing is bothering a lot of the members of the committee. They recognize, first of all, that you have won the battle in the Commission to exempt all existing Federal employees. I think your members certainly ought to recognize that, that in and of itself was a significant victory. Most of the members of this committee recognize reality, and when we get to the House floor, the odds are that we are going to have a closed rule. I don't know that, but I suspect we will have a closed rule. What they are fearful of is that they will have an up or down vote on the entire package, and they do not want all of the Federal employees suddenly deluging Members of Congress to say, "vote against this package, because new Federal employees are going to be covered."

Now, what will your position be if we fight that battle in committee and new Federal employees are covered. Assuming we go to the House floor with a closed rule, and we must vote up or down on the package, am I then to assume that you will then support the package?

Mr. KIRKLAND. Sir, I won't really know what you are voting for, if you simply have in the committee bill the broad proposition of coverage of new Federal employees, but you have no plan.

Mr. JENKINS. This committee has no jurisdiction over that plan, so we will not be voting upon that. We will be voting upon the tax package.

Mr. KIRKLAND. No one will know what they are voting for.

I would like to see what the Post Office and Civil Service Committee does with the plan.

Mr. JENKINS. A lot of us would like to see that, but, unfortunately, we just have a yes or no button. I want to say that I hope that the Federal employees understand that they have already won a significant battle-not to cover any of the existing employees, and they ought to recognize that fact.

We, too, have to face some reality, and you have done a good job in the Commission in protecting those existing employees, but I don't think that, in reality, that we are going to exempt new employees.

Mr. KIRKLAND. Mr. Jenkins, speaking as a trade unionist, I do not believe, that many trade unionists would regard their duties as well-fulfilled if they, say, froze the wage level or maintained a certain wage level for those employees who are members who happen to be working at a particular workplace at a given time, but accepted a new wage scale substantially lower for all future employees, and that is why we would like to see what it is.

Mr. Jenkins. Of course, I think at that point my only answer would be that obviously for new employees, there is another day to try to forge an equitable retirement plan with a civil service plan and social security to protect them. But I really feel that the Members of the House will probably have the option of either voting for a plan that includes new Federal employees or voting against the entire plan.

That is the option that we will ultimately have, and I simply raise that, because I do not see any other alternative.

Thank you, sir.

Chairman Rostenkowski. Mr. Ford?

Mr. Ford. You mentioned that one item in the consensus recommendations which you were very reluctant in accepting is the one time cost-of-living delay. You talked about the poorest beneficiaries being given compensating increases in their supplemental security benefits.

Are you referring to the SSI not being affected by the 6-month delay in social security; that it would not apply to SSI?

Mr. Kirkland. I was referring to the proposed increase in the disregard from $20 to $50.

Mr. Ford. Is that supposed to be in lieu of a cost-of-living adjustment by the Commission?

I talked to Mr. Ball yesterday, and he made mention that the Commission did not address that particular issue and whether or not it would apply to the SSI recipients.

Mr. Kirkland. That is, frankly, not clear to me, either.

Mr. Ford. You were referring to the $20 in disregard?

Mr. Kirkland. Correct.

Mr. Ford. The Commission did not take any position on the 6-month delay for the SSI recipients?

Mr. Kirkland. That is my understanding.

Chairman Rostenkowski. Thank you very much, Mr. Kirkland.

Mr. Rangel. Mr. Chairman?

Chairman Rostenkowski. Mr. Rangel.

Mr. Rangel. If the criteria that you outlined in your testimony for accepting a proposal for mandatory coverage, that is, what you would expect in the supplementary budget, were adopted by the bipartisan leadership, given the same type of assurances that were given to the Commission, would you then be in a position to support the package?

Mr. Kirkland. Speaking for the AFL–CIO, if those proposals were added, yes.

Mr. Rangel. If the criteria was supported, if they said that they would not accept less than what you have outlined, would that be enough to move on and leave the rest up to the Congress?

Mr. Kirkland. That is not too clear to me, sir.

Chairman Rostenkowski. Thank you, Mr. Kirkland.

Mr. Conable. Is this a panel? Can we stand so much distinction at one table?

Chairman Rostenkowski. Only because the Senate has come into the committee room on Ways and Means and set a different precedent, the ranking Member and the Chairman are going to have their picture taken with Mr. Kirkland as well.

It is a pleasure for us on this side of the building to welcome two distinguished members of the Commission that has fashioned as what we look upon as a fragile package, but a package that certainly can, if delicately balanced in this committee, pass the House of Representatives.

We know that the more difficult area is the long term, and you have made some observations with respect to the long term in which we have intense interest. We also hope in a very short while, the ball will be in your court.

Of course, we hope as well that when the ball gets in your court, you keep the court as clean as possible, without smudging the ball that will fly from one end of the court to the other, so that when we get to conference, if a conference is needed, that we can expedite this matter and send to the President a package that we will both agree on.

Having said that, Bob Dole, it is always a pleasure to have you here with us, accompanied by another outstanding member of the Senate, the representative from New York.

We are looking forward to your counsel and your advice, and our discussion.

Mr. CONABLE. I can't miss this chance, also; we are going to have a sufficient bounce with that ball, too—first, I suspect.

I would like to note that two-fifths of the 5-person group that worked out the bipartisan compromise is before us right now, and about four-fifths of the adroitness in the negotiating team. Let me tell you I am proud of the job you both did, and thank you for coming over and advising us now, because we need all the advice we can get.

Chairman ROSTENKOWSKI. Bob, go ahead.

STATEMENT OF HON. ROBERT DOLE, A U.S. SENATOR FROM THE STATE OF KANSAS, AND A MEMBER OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Senator DOLE. I have a very fine statement I would like to put in the record.

Chairman ROSTENKOWSKI. Without objection, your entire statement will be put in the record.

Senator DOLE. The last time I was here, I testified on indexing, a great change in tax policy. If I have that much success with this statement, it would be helpful.

I want to acknowledge, not as a member of the Finance Committee, but as a member of the National Commission, that there is a lot of concern about this package. I doubt that anybody on this panel—if they could have done it themselves—would have recommended this compromise as their package.

I want to underscore for the members of this committee, however, and I will be doing it in our own committee starting on the 15th of February, that if this is not the package you would like, but let's see the one you would like.

I ask my colleagues who don't like this compromise, what do you propose? They are finding it very difficult. I certainly believe Alan

Greenspan and Bob Ball and the others on the Commission who worked so hard, deserve credit. But now it is in our court, your court first, and I want to commend the chairman for moving very quickly.

It is my hope that we can keep the social security bill clean, clean from prospective payment legislation, clean from unemployment compensation legislation, clean from a lot of other things. Many Members in the Senate are now looking with some relish at this possibility.

I would hope that we could limit this to social security. We are going to make an effort on the Senate side. I have talked to the leadership to see if we can't say, OK, there will be other tax bills coming along. If we could stick together on this package, it would be very helpful in what we must address later on this session in a number of other areas.

We introduced the Commission recommendation's as S. 1. We know there are some problems with the bill. For example, we are concerned, as Congressman Ford is, about SSI, and whether or not there should be a COLA delay for that program. We addressed the SSI income disregard. We thought that was of some help.

There is a separate question which we did not address in the compromise, medicare. That trust fund is in great difficulty.

Also there is the notch problem in the provision to tax benefits, which will have to be addressed. There are probably other problems that we will discover.

I don't quarrel with the concerns just expressed by Mr. Kirkland. Perhaps we can urge the appropriate committees to come up with a supplemental benefits program for Government employees. Members in the House and in the Senate would at least know that there is something in the works, even if not precisely what it is.

There are some real concerns, I must say, that even though we have enough money between now and 1990, it may not come in in the right years. We may have some problems in 1985, 1986, or 1987. There may need to be some adjustments in the package that would not do violence to the compromise.

If there is any thought about dropping out one of the major provisions, then I believe everything falls apart. No one would be bound to do anything then except to fight it out.

There is some concern as to whether the self-employment tax should be a credit or deduction. We had some discussion of this in the Commission. We were told by the NFIB that they prefer a deduction. I am not certain it was fully understood, but that is what they indicated. We tried to accommodate some of those concerns. Now we are told, though, by the realtors and other so-called independent contractors, that they would prefer a credit.

Finally, we have, of course, the long-term deficit. I introduced, with Senators Armstrong, Heinz, Laxalt, Danforth, and Wallop, S. 76, which would gradually raise the retirement age after the turn of the century from 65 to 66 and adjust the age to changes in longevity thereafter. It seems to me that this is a reform that we should make. People are living longer, there is no question about that, and this is a very gradual change.

Mr. Chairman, and other members, I appreciate your willingness to bite the bullet first. This issue is still not without controversy.

There are a lot of people out there spending a lot of time, sending in postcards to repeal withholding on interest and dividends. We are going to look into the taxes that banks don't pay, to see if we can't help accommodate them, keep them busy on something that ought to really concern them.

We are going to work with this committee as much as we can to see if we can't have the National Commission's recommendations passed.

What is your deadline?

Chairman ROSTENKOWSKI. We expect to have it on the floor March 10, if not earlier.

It comes over to you by the 11th or 12th.

Senator DOLE. We are prepared to go as you are—as long as it takes. We will have a pretty good indication where you are headed.

I don't anticipate any real changes in the House bill that will be necessary except maybe the long-term solution. Hopefully we won't have much of a difference there either.

[The prepared statement follows:]

STATEMENT OF HON. BOB DOLE, A U.S. SENATOR FROM THE STATE OF KANSAS

Mr. Chairman, I appreciate the opportunity to testify before the Ways and Means Committee today to offer my perspective on the consensus recommendations of the National Commission on Social Security Reform. The speed with which this committee is moving and the comprehensive nature of these hearings demonstrate a real commitment to resolving the social security financing problem in the early months of the 98th Congress.

We also plan to move quickly in the Senate. On Wednesday, January 26, I introduced the recommendations of the National Commission as S. 1, co-sponsored by a bi-partisan group including Senators Moynihan, Heinz, Baker, Stevens, Laxalt, Danforth, Kennedy, Bentsen, Murkowski and Stafford. Our hearings in the Finance Committee will begin on February 15. I hope we will be prepared to mark up this legislation early in March. In my view, there is no more pressing domestic issue than social security financing and a resolution to this problem should be our highest priority.

The consensus reached by the National Commission holds the potential for marking the end of a bitter period of political controversy. As is clear from the twelve members who supported the package, both political parties were represented as were the interests of the elderly, organized labor and business, and general taxpayers. Republicans and Democrats, the House and the Senate, Congress and the Executive all demonstrated the degree of cooperation so essential for enacting a responsible social security financing bill. In the final weeks of our deliberators, we engaged in intensive negotiations which were, to a large extent, free of the political partisanship that so seriously damaged efforts for responsible reform in 1981. In the last analysis, consensus was only made possible with the cooperation and approval of President Reagan and House Speaker O'Neill.

Certainly no one member is happy with every specific recommendation. The important fact is that consensus was reached on how to save the system. S. 1 would close the short-term deficit identified by the Commission, and go a long way toward closing the long-range deficit. It would require concessions from all of the parties who have a stake in social security—current and future beneficiaries, taxpayers, and government employees who do not now contribute to the system.

REFINEMENTS MAY BE NECESSARY

As a compromise measure, S. 1 contains recommendations that carefully balance many interests. To the greatest extent possible, therefore, these recommendations must be considered as a package. Commission members recognize, however, that many details remain to be worked out within the legislative process. Some of the specifics are in need of improvement; some are in need of refinement.

For example, the way benefits are taxed in the Commission package, and in S. 1, would create a "notch". People with incomes below the thresholds would pay no taxes at all on their social security benefits, whereas individuals with just a dollar of income over the thresholds would pay taxes a a full 50 percent of their benefits. Certainly, there will be strong support for correcting this anomaly by phasing in the amount of benefits subject to taxation.

Other revenue provisions of the legislation also raise a number of practical and technical issues that will no doubt have to be addressed as we move through the legislative process. To ensure that taxes are paid on social security benefits, for example, the bill includes a provision for information reporting to the IRS and the social security beneficiary on the amount of benefits paid. It should be possible to implement this system without causing undue concern to beneficiaries, the vast majority of whom will not owe income tax on their benefits. We will want to be sure that this system is effective and fair.

Also, I am aware that there are concerns about the self-employed tax. Is a deduction or a tax credit the most appropriate offset for the higher tax? Should the self-employed receive the tax credit provided to employees in 1984? I can assure interested parties that we will receive testimony in the Finance Committee hearings, as I am sure you will in the Ways and Means Committee. These issues will be addressed when the legislation is marked up.

The delay in the social security COLA raises questions for other programs. For example, when the social security COLA is delayed, the annual increase in Supplemental Security Income (SSI) payments is also delayed. This was not recommended by the National Commission, but instead results from the way the SSI title of the Social Security Act is linked to the OASDI title. We in Congress will have to make an explicit decision in this regard. A similar problem is created in the SMI (Supplemental Medical Insurance) program. We will have to consider whether the increase in the SMI premium should continue to take place each July, as it would under this legislation, or whether it should be synchronized with the OASDI increase.

Finally, it should be noted there were unique problems in the drafting of the equity provisions. These problems resulted from well-known gender-based distinctions now in the law. For example, the Commission agreed to allow benefits to be payable to divorced widows and widowers who remarry. Divorced widowers benefits are not now in the law, however; they are paid under a Supreme Court ruling. By liberalizing the treatment of women, therefore, the treatment of men is liberalized indirectly. This type of problem will be corrected by later legislation designed to eliminate gender-based distinctions in the Social Security Act.

I feel confident that these, and any other problems that may become apparent as the legislation is carefully considered, can be handled within the normal legislative process without jeopardizing the basic bipartisan agreement. With the essential elements of a consensus bill before us, we in Congress are in a strong position to hammer out these details and enact legislation in the early months of the 98th Congress.

LONG-TERM DEFICIT MUST BE ELIMINATED

We have a big job ahead of us. We face many difficult decisions as to the details of the legislation, and the adequacy of the measures proposed. The balance of the long-term deficit also remains to be addressed, although I know there are some who would prefer not to deal with this problem now. But I remind my colleagues that confidence among young people in the long-term viability of the system is critically low. In my view, this is in no small measure due to our failure to ensure that the benefits due in the future can be financed. This is why I introduced, along with Senators Armstrong, Heinz, and Danforth, Laxalt, and Wallop, S. 76, a bill to implement the majority recommendation of the National Commission. This bill would gradually raise the retirement age after the turn of the century from 65 to 66 and, beginning in 2012, gradually adjust the age to changes in longevity so as to eliminate the deficit in the cash benefit programs (OASDI).

It should be noted that neither of the bills, S. 1 or S. 76, deal with the very serious problem in the hospital insurance (HI) program. As my colleagues are aware, the HI trust fund is likely to be insolvent before the end of the decade and, over the long-range, the deficit in HI is even larger than projected for the retirement program. We, in the commission, were well aware of these facts. We did not make recommendations in this regard, however, for some very practical reasons. The problem is HI is less pressing; the causes of the problem are quite different than those in the cash benefit programs; and a separate advisory council has been named specifically to make recommendations on HI.

PROMPT ACTION ESSENTIAL

The American people—the 36 million people receiving benefits as well as the 116 million working people who support the system—deserve the speedy consideration of this bipartisan package of recommendations. Prompt action is essential not only for the peace of mind of beneficiaries and taxpayers, but also because of the real solvency constraint we face. As all of us are acutely aware, retirement benefits will be in jeopardy in July.

I know that Chairman Rostenkowski shares my commitment to seeing that the essential elements of this reform package—as endorsed by President Reagan, Speaker O'Neill, Majority Leader Baker and others—are adopted by the Congress and enacted into law by May. Moving quickly to shore up the nation's largest domestic program is in all of our interests.

Chairman ROSTENKOWSKI. Senator Moynihan?

STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM THE STATE OF NEW YORK, AND A MEMBER OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Senator MOYNIHAN. I would associate myself with everything Senator Dole has said, but I would like to make one point to the committee that you might want to know. We have introduced a measure as S. 1, and sought a number of cosponsors. On Senator Dole's side we have as cosponsors Senator Baker, Senator Heinz, Senator Stevens, Senator Laxalt, and Senator Danforth.

On our side, there is Senator Bentsen and Senator Kennedy. We have a kind of range from Senator Laxalt to Senator Kennedy—about as wide a range as you can get in the Senate—which is reflective of the feeling that the Washington Post described when it said that the Commission proposal comes, and I quote, "as close to absolute fairness as any social security revision could ever be," and we are committed to it.

We are moving as quickly as we can, and we are very much honored that you should ask us here. We will respond to any questions you have, to the extent that we, as Commissioners, might have views that would be of interest to you.

[The prepared statement follows:]

STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM THE STATE OF NEW YORK

S. 1, the Social Security Amendments of 1983, embodies the recommendations of the National Commission on Social Security Reform. Senator Dole and I served on the Commission along with thirteen other White House and Congressional appointees in a spirit of bipartisan cooperation. The success of the Commission in finally reaching agreement on January 15 was due to the extraordinary efforts of Chairman Greenspan, Senator Dole, Congressman Pepper, and Congressman Conable during exhausting negotiations. I congratulate them all. As with any effective compromise, the final agreement was not completely satisfactory to any one participant. But taken together, these recommendations offer a fair and equitable solution to the $150–$200 billion short-term Social Security financing problems and take us a long way toward eliminating revenue shortfalls projected over the next 75 years for the system. At the outset of his State of the Union message, the President pointed to the work of the Commission as an example of what a bipartisan spirit can accomplish.

The vital necessity of solving Social Security's problems was manifest. The shrinkage of the Trust Funds in recent years that resulted from the deterioration of the national economy, coupled with mounting public concern that the system was becoming insolvent, underscored the need for bipartisan action. On December 16, 1981, by executive order of the President, the National Commission was created and charged with providing appropriate recommendations to the Administration and the

Congress "on long-term reforms to put Social Security back on a sound financial footing."

The Commission met nine times during 1982 to hear the counsel of experts and examine alternative approaches. These deliberations led to a consensus that there is a short-term problem—a $150–$200 billion shortfall between now and 1989; that from 1990 through the early 2000s the system will be in surplus; and that, due to the retirement of the "baby boom" generation, there is a long-term problem beginning after 2010. Equally important, the Commission agreed that "Congress . . . should not alter the fundamental structure of the Social Security program or undermine its fundamental principles."

However, there was no agreement on solutions to the Social Security crisis. Commission members were deeply divided on recommendations to cover both the short-term and long-term revenue shortfalls. The impasse persisted throughout December, despite the heroic efforts of Chairman Greenspan to achieve compromise. The Commission's reporting deadline was extended from December 31 to January 15, 1983, but there was little hope of a successful result.

On January 3, a New York Times article by Senator Dole appeared, making the case that "[T]hrough a combination of relatively modest steps, including some acceleration of already scheduled taxes and some reductions in the rate of future benefit increases, the system can be saved." The door was opened for compromise. On January 3, in the course of opening ceremonies of the 98th Congress, I spoke with Senator Dole, who agreed that we could not give up. There followed an exhausting series of negotiations between the Commission and the White House. By January 15, final recommendations were agreed upon and the result announced as the Commission report.

Twelve of the fifteen Commission members, the President, the Speaker and other Congressional leaders agree that the Commission recommendations strike an acceptable balance between tax increases and reductions of benefit increases. No Commission member is satisfied with every recommendation. No member of the Congress will be satisfied with every recommendation. But as a Washington Post editorial argues, the package comes "as close to absolute fairness as any Social Security revision can ever be." The balance nonetheless is fragile. This legislation will not survive if the President, Members of Congress and the people allow it to be significantly altered as it makes its way through the legislative process.

More than the integrity of the Social Security system is at stake here. When S. 1 passes, we will have demonstrated that there is a governing center in American politics. This Commission is just an example of what can be done. First, get your facts straight. Second, decide to live with them. Third, resolve to surmount them. Because, fourth, what is at stake is our capacity to govern.

Chairman **Rostenkowski**. Thank you very much.

In our opinion, the Commission has done, with your assistance, a great job.

We are certainly going to try to mirror the short term, refine if necessary, and work with you throughout the whole breadth of this legislative process.

As chairman of the Committee on Ways and Means, I would like to assure you that we are going to try to keep this as clean a social security bill as possible.

If it is comforting at all, and we have no authority over the legislative process in the Senate, we would like very much to see that the bill we send over is a clean bill, and only in the social security area address amendments, because if we are going to have the decoration that is possible to take place, we will just prolong the process, and will, in great measure, discourage the membership on this side of the aisle.

I know that there will be tax provisions that we will initiate that you will have an opportunity to refine in the Senate. If there is any possibility of reassuring you, we expect to continue to legislate even after social security, so you will have some vehicles with which you can work.

Mr. Gibbons?

Mr. GIBBONS. First, I want to commend both of you for the fine work you did on the Commission, and it took a lot of effort and a lot of skill.

I hope that we can have this matter on the President's desk before the Congress begins its district work period on the 24th of March, and certainly that is what I will be pushing for on this side of our Congress, and I certainly appreciate every effort that you will be able to make over there to keep this bill limited to social security.

We will try to do the same thing over here.

Senator DOLE. The fact that you and others are expressing that thought will not be lost on our side. We are going to try to impress upon them that obviously we have a right to change whatever the House——

Mr. GIBBONS. Certainly.

Senator DOLE. This is an unusual circumstance. We do have an emergency in a sense. We have to have this legislation enacted in time so that the provisions can be implemented by the Social Security Administration computers.

Mr. GIBBONS. My personal goal is the evening of March 23 to get it to the White House.

Chairman ROSTENKOWSKI. Mr. Pickle?

Mr. PICKLE. I think Senators Dole and Moynihan have been very instrumental in helping us forge this compromise package. I have had the privilege of working with you over the months in trying to find a solution. I appreciate your attitude and both of you being willing to go forward with the consensus.

I thank you both for your contribution.

Chairman ROSTENKOWSKI. Mr. Guarini?

Mr. GUARINI. Senator, your talent is very vital and critical in saving social security.

A point of advice: Mr. Kirkland talked about Federal and Postal employees. This apparently is something of substance. Yet many people before the Commission had stated that if we start unraveling any issue of substance, we will destroy the whole opportunity we have for saving the program, or at least the Commission's report, in essence, will be ditched.

From your vantage point, and experience in Congress, I wonder whether or not you feel that if we get into the issue of Federal and Postal employees, that we will be helping to unravel the Commission's report, which would lead to a disastrous conclusion.

Senator Moynihan?

Senator MOYNIHAN. Well, sir, first, Mr. Kirkland's reservation on this one score has a number of specific conditions and he said that if met, that would resolve his reservations.

It seems to me it is possible for them to be met, and I would hope right now the Office of Personnel Management is hard at work proposing a supplementary system.

I know that Mr. Myers, our distinguished Executive Director, is going to talk to you this morning about it.

It can be done.

It is done all over the country every day in collective bargaining arrangements.

Obviously, it has to be a parallel. Some signal from the administration that they are at work would help this right now, and you could bring the employees into the negotiations. But in the end, there are those of us who feel, how can an employee of the Social Security Administration say, I don't want to belong to social security?

It is a good thing for everybody.

Mr. GUARINI. Either they are in or they are not in, and, apparently, if they are going to be included in, the Postal and Federal employees will object to any form of inclusion from what I can understand?

Senator MOYNIHAN. Well, don't underestimate the process of reasoning together, as Lyndon Johnson used to say.

Mr. GUARINI. Senator Dole?

Senator DOLE. It was a difficult call. At one time we had everybody covered who had less than 5 years of service. Maybe we should have stuck with that. Then when we gave it up, everybody would have won something. But we went back to 3 years, then we moved off that to new hires. It is not that government workers are just going to pay taxes without getting something when they retire, they will receive all the benefits of coverage. I can't quarrel with anyone's opposition though.

I might point out that we are getting a lot of mail from individual members of the AARP, saying we support the package even though our leadership does not.

A lot of people coming into Federal service will look favorably upon what we have done.

Chairman ROSTENKOWSKI. Mr. Martin?

Mr. MARTIN. One question: Senator Dole, you pointed out the problem of the threshold for the $20,000-income single individual and the $25,000-income retired couple. For $1 above that, they would be taxed fully on half of their social security benefits, and you suggested the possibility of phasing that in.

If we consider that, won't it be necessary, in order to avoid a major reduction in one of the major revenue-producing parts of this package, to start phasing it in at incomes below $20,000 and $25,000, in order to offset revenues you are going to lose?

Senator DOLE. I do not have any cost estimates on this.

We raised this issue in the Commission deliberations, and we knew we had a problem. But we realized that we were not a legislative group, only an advisory group charged with making a recommendation. In my view, however, we must keep that figure, $168 billion. We may have to make some other minor changes in other portions of the package. I don't think we have to limit it to that one area, because that threshold was carefully arrived at. If we start lowering that threshold, then we will bring in many people we don't want to bring in as far as the recapture of benefits. Under this proposal, 11 percent of the beneficiaries pay some additional tax. I hope we don't extend much beyond that.

Mr. MARTIN. Those two provisions that you referred to would be the one with the notch for those whose incomes are above 20-some thousand dollars, and the one with the credit or deduction for the self-employed. They are not the minimal dollar amounts, but in the order of $25-35 billion out of that 168; so those are major, and there are not many other places to go to make up a substantial shift in the amount of revenues that those would produce.

It may require dipping a little lower before you start phasing it.

Mr. ANTHONY. Mr. Chairman?

Chairman ROSTENKOWSKI. Mr. Anthony.

Mr. ANTHONY. Senator Dole, I was very interested in 1982 in putting some type of provision in there for a prospective payment. I worked on that in subcommittee and in the full committee.

Inasmuch as the Commission has not addressed some savings in medicare, and we know that the medicare section is going to be in trouble, would it not make some legislative sense to include the proposed prospective payment legislation and merge it in with what we would do in social security, rather than making it two separate pieces of legislation?

Senator DOLE. Under normal circumstances, it would be a good idea. We started hearings this morning on prospective payment. Secretary Schweiker, the American Hospital Association, and others are testifying. If we do what you suggest, even though it may have great merit, then we invite—and you don't have to send out much of an invitation on our side—a lot of other amendments that would expand that good purpose. We are going to have enough difficulty, don't you think, Pat, just trying to limit this to a social security package?

Chairman ROSTENKOWSKI. Bob, that, as well as unemployment compensation, comes under the purview of the Social Security Act.

We are going to have secretary Schweiker up here to talk about prospective reimbursement.

Senator DOLE. We don't want to open up the floodgates. We have people who carry amendments around in their pocket just waiting for a bill to come along.

Mr. GIBBONS. I hope we will make every effort to keep this bill limited to traditional social security matters that involve the old age and retirement account and the recommendations of the Commission.

There will be plenty of time for other proposals, and I, for one, intend to vote that way.

Senator DOLE. There is another consideration. Say we pass this package with unemployment compensation and prospective payments, and we end up with a shortfall in the social security trust funds in 2 or 3 years. Social security recipients will believe it is because we added some things, like unemployment compensation, that they believe we should not have added. That is another consideration.

Mr. FORD. Mr. Chairman?

Chairman ROSTENKOWSKI. Mr. Ford.

Mr. FORD. Senator Dole, there are some areas which I touched on with Mr. Kirkland that the Commission did not address, that we will have to try to work out as we go into markup, both this committee, as well as the Senate. Do you think SSI is one of the provisions in which we did not receive clear recommendations, and we will have to work it out on this committee?

Senator DOLE. Yes, I think it is. Whether or not you have a 6-month delay, or something like that, for very low income people should be addressed specifically. We tried to avoid it in the Commission. We did increase the disregard, as Mr. Kirkland pointed out.

Chairman **Rostenkowski**. Mr. Campbell?

Mr. **Campbell**. Senator Dole, on SSI, did the Commission discuss the coupling problem and whether you should separate that under SSI from social security, and what your cost factors were?

Senator **Dole**. I don't believe we did. Let me check. It may have happened when I was not there.

No, we are informed we did not.

Mr. **Campbell**. I would like a little guidance in that field, because it is a problem that we are going to have to deal with, and either we have to address legislatively the coupling problem, or else you are going to have to get a failsafe system in there for that group.

I wondered, there was no discussion, I assume, on any of that?

Senator **Moynihan**. That is correct, sir. If I may say, we would, on our side, very much be interested in what you think should be done, if you think there should be specific provisions here.

Mr. **Campbell**. Well, I am concerned with the cost factor.

I know we are talking about the disregard, it being $750 million. I am not sure what you lose if you do not have the delay for the SSI recipients on a 6-month period over all. We just have to look at the numbers. How many of the 4 million are going to be picked up when they are dropped, and what do we have to have to have a failsafe position?

Senator **Moynihan**. Of course, perhaps Mr. Conable can tell you; anyway, you probably all know that we took the disregard from $20 to $50, and that simply represents the cost-of-living adjustment from the original $20. It does not represent an increase in real dollars at all.

Mr. **Campbell**. We will have to thrash this one out; we are all looking for the same answer to it, and I hope we work on the same pool.

Senator **Dole**. We did not address that, and it is something we will have to resolve at the committee level.

Mr. **Campbell**. It is also fair to say, though, that both your side and our side will be looking for an answer that won't drop some through the cracks.

Senator **Dole**. Right.

Chairman **Rostenkowski**. If there are no further questions, I would like to thank you gentlemen for joining us this afternoon.

It has been rewarding.

Senator **Dole**. I don't know about that, but we are glad to be here.

Chairman **Rostenkowski**. Mr. Myers?

Welcome, Bob, to the committee. You may proceed. We are looking forward to hearing from you.

Bob, if you will begin; please proceed with your observations.

STATEMENT OF ROBERT J. MYERS, EXECUTIVE DIRECTOR, NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Mr. **Myers**. Mr. Chairman, I will be discussing today only the possibility of covering new Federal hires.

I am still the Executive Director of the National Commission, but we go out of existence in 2 or 3 weeks, and I am speaking not on behalf of the National Commission, because some of the things I will be saying were not discussed by it, but rather these are my own personal statements.

Yesterday, as you will recall, there was put in the record by Mr. Trowbridge a statement that I had made about the controversy over the Commission's recommendation about covering new Federal hires. Some of the statements that have been made by others were not quite factually accurate. I have copies of that statement here today, and I would like to cover very briefly some of these criticisms that have been made and the answers to them. Second, I would like to present a very simple and equitable plan for a new supplementary independent plan for the new Federal hires who would be covered under social security, so as to give an equitable benefit package to them.

I think that, by and large, it will meet the requirements that Mr. Kirkland mentioned this morning—maybe not precisely in all respects—but it certainly moves very much in that direction.

I am having distributed now the statement of this possible new independent supplementary plan, and I will discuss it in a few moments.

In the statement that I gave you yesterday, there were four principal criticisms that have been made. I will briefly say why I don't think that they are valid.

The first criticism is that covering all new hires under social security will bankrupt the civil service retirement system, because there will be a decreasing group of active workers on whose salaries contributions will be paid by them and the Government.

This displays a lack of knowledge of the principles of funding pension plans. The present civil service retirement fund includes a number of plans, not one single plan. There are a number of plans within the civil service retirement fund that are closed groups, just consisting of people retired in the past and with no more active employees subject to those provisions. Rather, the civil service retirement system is financed, as far as the Government is concerned, by a percentage of payroll taken on the entire payroll of all Federal civilian employees.

Thus, if you put in a new supplementary independent system, those people, their pay would be part of the financing base of the civil service retirement fund, and their payroll would be the basis for determining an average, or aggregate, contribution, which would support all the plans in the civil service retirement fund, including that for the present employees and the new one for new hires.

The second criticism that has been made is that the social security system will have only short-term cash-flow gains and that the additional benefit liabilities created will put it in a worse position in the long run.

The position which the Commission took is that we are not covering Federal new hires merely to help finance the social security system, but rather it is more logical that Federal hires should, like almost everybody else in the country, be in the system, and that it is really better for them to be so covered.

Anybody who is under Federal civil service retirement and has less than 5 years of service gets nothing out of it, and they can lose out because they have a gap in their social security record when they go back into the private sector. They might get greatly reduced benefits.

The fact is that covering new hires under the social security system will not only provide favorable short-term cash flow, but also, over the long run, there will be a net gain to the system, averaging 0.3 percent of taxable payroll.

The National Commission has stated this in its report. The actuaries at the Social Security Administration have said this for years. Where this statement that coverage of Federal workers under social security will not result in savings over the long run comes from is that, at one time, a former Deputy Commissioner of Social Security, off the top of his head, made this statement in a congressional hearing, and ever since then, this one misstatement has continuously been quoted.

Mr. GIBBONS. Would you repeat that again for emphasis and go back over that?

Mr. MYERS. About 3 years ago, a then-Deputy Commissioner of Social Security, in testifying before the House Post Office and Civil Service Committee made the statement that there was no long-term gain to the social security system if Federal employees were covered. He made this, not as part of his prepared testimony, but just in answer to a question, and the fact is that he was wrong.

His actuaries told him that he was wrong at the time, but that statement is on the record, and some groups continually quote it.

The reason that there is a long-term gain to the social security system is twofold: First, about 80 percent of those who retire under civil service retirement also get social security after age 62, and they get the heavily weighted benefits with which you are so familiar, because they are treated by the social security program as low-paid employees.

The second reason is that Federal employees, as a group, are higher paid than the average worker in the country. I am not saying that this is so on a job-for-job basis, but because of the mix of jobs, they are higher paid. The more higher paid people that there are in the system, the more this helps the system, because of the weighted nature of the benefit formula.

The third criticism that is made sometimes is that the new hires will be worse off because they will have only social security benefits.

As you heard the discussion this morning, I think that it is virtually a certainty that the Congress is not going to leave new hires with only social security benefits. There are ways of developing independent supplemental plans, just as private industry has so successfully done, that will give Federal employees a fair deal in this manner.

This is not too difficult a matter.

Any private company that wants a separate pension plan, can develop it in 2 or 3 months. I am certain that the Government, Congress, OPM, and others acting together, can develop long before next January 1 a reasonable and fair, separate, independent system for new hires that will be part of the civil service retirement system.

The fourth criticism that is made is that some people claim that the Government, and thus the general taxpayers, would have higher costs, because they will be required—more or less immediately—to pay off the unfunded accrued liability of the civil service retirement system, which is at least $200 billion by some estimates, and it could be as much as $500 billion under other funding bases.

There is no reason why this unfunded accrued liability has to be paid off. Interest on this unfunded accrued liability can be paid out over all future years and can be based on the payroll of all Federal employees, and does not have to be based on the payroll of the present employees. Thus, this interest would be based on the total Federal civilian payroll, including new hires. Such a total payroll will always be there. The present financing method does that, and it could continue that way.

There is no reason to fund that unfunded accrued liability for an employer like the Federal Government, which we can assume is always going to be in existence.

Now, if I might turn to the new document that I passed out today, this represents my thinking on a possible revised independent supplemental civil service retirement plan that would be added to social security for new hires.

This, of course, is not the final answer. There are many ways of doing it. I have not gone into all of the details. At least, I put this forward as a framework to consider. There are many other experts in this field. This proposal has not been cleared with OPM, or anybody else.

The objectives underlying this proposal are to have as simple an arrangement as possible and to provide equitable treatment to the employees affected and have the same overall cost to both employees and the Federal Government for social security, and this independent supplemental plan combined.

Somewhat the same general procedure could apply to the numerous other Federal employee retirement systems, of which civil service retirement is by far the largest. No changes would be made in the early retirement ages currently applicable under civil service retirement. The only changes in benefit amounts for new hires would be for months when the individual is also eligible for social security benefits.

Thus, for example, considering retirement benefits, exactly the same civil service retirement amount would be payable and under the same condition as at present for persons who retire before age 65, during the period before that age. Then, at age 65 and over, if the individual is then eligible for social security benefits on the basis of both the Government wages that were covered and the private wages that were covered, the amount payable under civil service retirement would be reduced, but then a social security benefit would also be paid.

Specifically, for these new entrants, the civil service retirement amount after age 65 would be 50 percent of what it would be under present law, but when it is supplemented by social security, the total retirement income would be about the same.

I should mention that I am just talking here about earnings under the maximum taxable earnings base. For people earning over the present $35,700, the same amounts for earnings above such base would be payable as under present law.

For people under the base, this combination of roughly half of what the present civil service retirement formula gives, plus social security, would put such persons in about the same position as they would be under present law.

The same general procedure would apply to disability benefits.

The full present civil service retirement benefits would be payable for all months when the individual was not eligible for receipt of social security disability benefits—for example, when the disability is not severe enough to meet the social security standards, or during the waiting period for social security benefits.

Also, the same general procedure would be followed for widows' benefits under the new supplementary independent civil service retirement system.

In other words, the procedure of reducing the civil service retirement benefits would only be done when eligibility exists for both civil service retirement and social security benefits, and then the revised method for calculating the supplementary civil service retirement benefits would be followed.

Child's benefits would be eliminated from the new plan for new hires, because the social security benefits would generally be larger.

Finally, looking at the other side of the coin, how do you finance the proposed new system?

As to the employee contribution rates, the present basis of an employee rate of 7 percent, plus the hospital insurance tax rate under social security, would be continued.

The 7-percent rate would apply to the total salary, including that above the social security base. Then part of this 7-percent employee rate would be assigned to social security—whatever the social security tax rate produced—and the rest of it would go to the civil service retirement fund.

The Federal Government would continue to meet the remainder of the cost of the independent supplemental CSR program for new hires, plus the employer share of the social security tax rate.

For people below the base, there would not be much employee money going into the civil service retirement fund. However, there would still be a very large amount of employer money going in, because the cost to the Government, as employer, under the civil service retirement system, averages 33 percent of payroll. Even after reduction by the social security tax rate, there is still a lot of money going in to support this suggested new independent supplemental system.

Mr. Chairman, this is my first thought on how to provide an independent supplemental plan. I have actually developed this plan and had it "in my hip pocket" for a number of months.

Obviously, this plan is not supposed to be the ultimate perfect answer, but I would think that it is a good basis for consideration.

Thank you, Mr. Chairman.

[Mr. Myers' general memorandum of February 1, 1983, follows:]

National Commission on Social Security Reform,
Washington, D.C., February 1, 1983.

Subject: Possible Method of Modifying Civil Service Retirement System for New Hires if They Are Provided Social Security Coverage.

This memorandum will present a possible method for revising the CSR system for new hires if OASDI coverage were extended to them, effective January 1, 1984. The objectives underlying this proposal are to have as simple an arrangement as possible, to provide equitable treatment to the employees affected, and to have approximately the same overall cost to both employees and the Federal Government. (It should be noted that, beginning in 1983, all Federal employees are covered under HI, and the tax rates therefor are payable both by the employees and the Federal Government.)

Although this memorandum refers only to the CSR system, the same general procedure could apply to other Federal-employee retirement systems (for example, the plans for Members of Congress and employees of the Legislative Branch).

No changes would be made in the early-retirement ages currently applicable under CSR. The only changes in benefit amounts for new hires would be for months when the individual is also eligible for OASDI benefits. Thus, for example, considering retirement benefits, exactly the same CSR amount would be payable (and under the same conditions) as at present for persons who retire before age 65, during the period before that age. Then, at age 65 and over, if the individual is then eligible for OASDI benefits (on the basis of covered earnings from Federal service and other employment combined), the amount payable under CSR will be lower than at present.

Specifically, for new entrants after 1983, the CSR amount after age 65 under the foregoing circumstances would be determined from two average salaries—(1) the high-3-year average salary determined from the OASDI covered earnings (i.e., not counting any salary above the maximum taxable earnings base) and (2) the high-3-year average salary based only on amounts above the OASDI minimum taxable earnings base. (It is very likely that the former average salary will be that for the last 3 years of service, but the latter average salary might be on earlier periods of service—in particular, for persons whose total salary does not rise as rapidly as the general wage level, and thus not as rapidly as the OASDI earnings base rises.) The benefit factors applicable to the first type of average salary would be 0.75 percent for each of the first 5 years of service, 0.875 percent for the next 5 years of service, and 1 percent for years of service in excess of 10 years—i.e., half of those currently used for present employees (namely, 1.5 percent for the first 5 years of service, 1.75 percent for the next 5 years of service, and 2 percent for years of service in excess of 10).

These benefit formulas are intended to produce the same aggregate benefits (and thus cost) as the present system. However, the distribution of benefit amounts among employees (particularly those at different earnings levels) would eventually be somewhat different.

The same general procedure would apply to disability benefits. The full present CSR benefits would be payable for all months when the individual was not eligible for receipt of OASDI disability benefits (e.g., for disabilities which meet the CSR definition, but not the OASDI one and for disabilities during the OASDI 5-month waiting period even though the disability met the OASDI definition). When the individual would be eligible for disability benefits under both systems, the revised method of computation of CSR benefits would be applicable.

The same general procedure would also be followed for widow's benefits under CSR, by being applicable only in months when eligibility exists for both CSR and OASDI benefits and then applying the revised benefit computation method for the primary benefit described previously. Child's benefits under CSR would be eliminated for new hires (because the OASDI benefits would generally be larger).

As to employee contribution rates, the present basis of a 7 percent rate, plus the HI rate (up to the earnings base) would be continued. Part of the 7 percent rate would be allocated to the OASDI Trust Funds (with the amount being equal to the OASDI tax rate at the time multiplied by earnings up to the earnings base), with the remainder going to the CSR Fund. The Federal Government would continue to meet the remainder of the cost of the independent, supplemental CSR program for new hires, plus the employer share of the OASDI-HI tax rate.

Robert J. Myers,
Executive Director.

Mr. Gibbons [presiding]. Mr. Conable?

Mr. **Conable**. I appreciate your coming before the committee and the expertise you brought before the Commission.

I have a question that has not really been considered as far as I know.

It is a matter of some concern, and it has to do with the COLA, which, under the bipartisan recommendation, would be postponed for 6 months.

That gives us up until April to determine what the cost-of-living adjustment is going to be.

If we were to have a severe break in oil prices, whatever desirable effect that might have, presumably it could result in the COLA adjustment going below 3 percent.

Now, if that occurs, people will be told that they are going to have their COLA postponed until January, then suddenly they will be told, sometime before January, they will not get any COLA at all.

Might it not be a desirable thing for us in this package to waive the 3-percent rule for this year? There is some irony in the condition we find ourselves in, but, of course, that is one of the reasons that this compromise has been politically acceptable, and it is obvious that the COLA is going to be small, anyway, but if it is so small that we get no COLA adjustment at all, there may be some sense of betrayal when we arrive at the postponement date and find nothing payable.

It is going to be close. The inflation rate continues to drop, obviously, and it is not at all impossible to think of a situation in which it might drop quite substantially, given the components fuel in the CPI.

Well, would you speculate with me a little about this?

It is something the Commission did not consider, and it is something that the committee will have to consider.

We are talking about the possibility of an unexpected development, which I would hope we could deal with on some sort of a contingency basis.

The 3-percent rule is a good one generally, but, given the delicacy of the negotiations we have been having, I see it also as a possible bombshell that could cause more problems than we would normally get, were we to find ourselves in the celebrating condition of having a less than 3-percent cost-of-living increase during the critical 12-month period.

Enough said.

Would you talk to me a little about this? I am sure you have considered this, and I would like to have your views.

Mr. **Myers**. I will certainly be glad to talk with you about this subject. Any views which I am expressing now are purely my own.

Mr. **Conable**. Yes, we did not discuss it in the Commission. I hope I made that clear, but it is something that has begun to worry me as it has been called to my attention by members of my staff.

I do think we have to think about it.

Mr. **Myers**. In some of the most recent meetings of the Commission, we saw the possibility that the COLA for 1983 would be between 4 and 5 percent. But now, with the CPI—on which the COLA is based—having dropped in the last 2 months, the situation may be different. If the CPI just stayed constant for the next 3 months, the increase would be 3.4 percent.

However, if the CPI keeps dropping in the next 3-months, we could well dip below the 3-percent trigger. I think that it would be an excellent idea to waive that 3-percent trigger requirement this year. Thus, if the CPI rise did drop to 2.9 percent, we would pay the 2.9 percent; however, I don't think it will go too much below that, so that this change would be very desirable. As far as the fiscal effects on the trust fund, it is really much, much better off than anybody anticipated if the COLA increase is below four percent.

Mr. CONABLE. You don't see this as something that might upset the fragile balance of the report, since it was not considered by the Commission; is that correct?

Mr. MYERS. I think so. I think that the vast majority of the members of the Commission would say that, this is a reasonable thing to do. The 3-percent trigger was really not done on policy grounds, but rather on administrative grounds.

Mr. CONABLE. That is the old law, but nothing that we have changed as part of our Commission report.

Let me ask you if you see any other similar possible bombshells that might occur as a result of the changing economic pattern around us that the Commission did not report?

I think that is something we really have to consider, but is there anything else that immediately comes to your mind that we ought to talk about?

Mr. MYERS. I think that the only other thing—and it has been mentioned by several in passing, but I feel particularly strong about this—is that a stabilizing or fail-safe provision must be put into the package. I don't think that such a change violates the consensus. Personally, I am very strongly in support of the package.

If I had been a member of the Commission, I would have certainly voted for the consensus. If you pull one thing out of the package, it will be unraveled. What I am suggesting would be a bulwark to the proposal and would not be tearing it apart.

Some sort of a fail-safe device must be put in, because, as you know, in 1983 and 1984, there is adequate additional financing, but 1985, 1986, and 1987, the financing of the package is pretty weak.

The situation in 1988 and 1989 are fine, but you have to get to there. Some sort of a fail-safe device or some sort of a cost-controlling device must be put in. This would assure that, if for some reason that I certainly can't predict, things turn around, and we have a situation like that which occurred in 1979–81, then we don't go through the pain 2 years from now of saying that we have another crisis on our hands.

I am certain that this can be done. There are different fail-safe devices. In our report we suggested several of them. I have my own preferences as to what ought to be done, but this is not the appropriate place to say so.

Mr. CONABLE. Thank you very much, Mr. Chairman.

Mr. PICKLE. Thank you.

Mr. Myers, as we proceed in the immediate days ahead, if you do have a preference, any thought with respect to a mechanism for taking care of any shortfall in the immediate years ahead, we would be glad to have them from you, so don't be hesitant.

You can help us with a possible solution.

Specifically about the plan you have recommended, we will be interested in receiving from you a written report, a suggestion about how you think the plan would work, and I commend you for being willing to just advance a plan on your own.

I assume it is not cleared by any governmental agency, or the Congress, or anybody else.

Several members of this committee are trying to come up with a reasonable plan, so I thank you for making a suggestion.

If I got your testimony right, can you be more specific about the differences in benefits payable under your proposal from benefits paid under the current system? You mentioned distribution of benefit amounts among employees would be different. How would they be different? In what respect?

Mr. MYERS. I did not work this out in great detail, because there was pressure of other work. However with the work that I did, I figured that, if people got social security benefits at age 65 or after, and if you added to that half of the civil service retirement benefit—not considering people earning above the base—allowing for the fact some might have spouses, the combination would give very closely in the range of what the present civil service retirement benefit is.

Civil service retirement benefits now are at about double the level that social security benefits are. Thus, if you take away half of the civil service retirement benefit and add in social security, it would be about the same result.

Mr. PICKLE. It would be about the same?

Mr. MYERS. My disclaimer here was it is not going to be precisely that for everybody, but it does give good rough justice.

Mr. PICKLE. What would happen to individuals who retire from civil service at age 55 when they reach 62? Would they get their benefits, social security, at 62?

Mr. MYERS. What I thought about that matter was that I would pay the full civil service retirement benefit up to age 65.

If persons took the social security benefits at 62, the reduced benefits, they would then be drawing both benefits, but after 65, they would be getting less. This would occur because the 80 percent they get under social security at 62 is the actuarial equivalent. Although people could take the full CSR benefit between ages 62 and 65 and, at the same time, the reduced social security benefit, it would be poor retirement planning from their standpoint to have higher benefits from 62 to 65 and lower ones later, in the aggregate. As far as the cost of the system is concerned, if people claim benefits at age 62 under social security, instead of waiting until 65, it does not cost anything over the long run, because it is an actuarial equivalent reduction. So, as far as the two systems are concerned, this double payment between 62 and 65 would be offset by the lower payment later, and there would be no cost to the system and people. In fact, I would advise anybody like that who retired at 55 not to take the social security benefit at 62, but rather take the full civil service retirement benefit until 65 but no social security benefit before 65. Then, at 65, the person should take the full social security benefit to offset the lower civil service retirement benefit after 65.

Mr. PICKLE. Well, those who retire at 62 might not agree with you.

Mr. MYERS. If they took it then, they would have more money between 62 and 65, but less money after 65. I thought of doing it the other way, and it seemed to me to be neater and cleaner to do it this way, because a lot of people don't retire at 62.

Mr. PICKLE. We will be in touch with you about the plan. Civil service people have every right to expect that their retirement plan would be protected. We must find the best and fairest plan to ensure that.

I thank you very much.

Mr. MYERS. That is exactly what I think, too, and that is what I was trying to achieve here.

Mr. GIBBONS. Mr. Gephardt?

Mr. GEPHARDT. Thank you, Mr. Chairman. I appreciate the work you have done on the Commission, and I appreciate your work when you were associated with the committee staff.

My question is, in general terms, assuming an integration plan like you have suggested, do you think the overall net aggregate cost to the U.S. Government would be more or would be less after the implementation of such a plan?

Obviously, we have to assume that less money would come in to civil service than now does, as you pointed out, but we would also have to assume that most Federal workers are now going to get social security, because they qualify at other times, so we have solved that problem in part. Do you have any ballpark estimate as to whether or not the government's cost would increase or decrease with regard to the new hires?

Mr. MYERS. As you pointed out, there will be less money going into the civil service retirement fund, but also less money going out, because of the reduction in CSR benefits at age 65.

As to the overall cost, I have not made any detailed calculations, but I believe from the experience I have had at cost estimating, that it would cost about the same, in balance, as the present system. There would be certain elements that would save money for the Government as employer.

When an employee leaves with less than 5 years of service, now this does not cost the Government as employer any thing. The persons get their money back, and that is it. Here, the social security tax will have been paid, and there are elements moving both ways. I would think that the cost to the Government as employer would be about the same.

Those who make the cost estimates for the civil service retirement system are the real experts, but there are no big surprises in here one way or the other.

Mr. GEPHARDT. When I say cost to the government, I include social security in the Government's pot of money.

Mr. MYERS. Yes.

Mr. GEPHARDT. Let me approach this question of how we deal with Members of Congress. I take it the Commission did not really deal with that in any significant way, other than I assume they would be treated like other Federal employees.

Even existing members will be included, which would be unlike what you have suggested with regard to other Federal employees. One of the problems you immediately confront is how to treat their existing civil service pension if indeed you bring them under, and I assume that in your plan you don't contemplate giving new hires the option of paying 7, or 6, or whatever it is, percent into social security and also paying a full 7 percent into the civil service pension as an option, and, therefore, getting the benefit structure of both programs?

Mr. **Myers**. I certainly would not recommend that. When you give options like that, then so-called antiselection occurs. Those who will gain by taking both plans will do it, and those who think they wouldn't gain would not do so. Therefore, the cost would be quite high.

I have not dealt here with what ought to be done about the congressional retirement system, which is really part of the civil service retirement fund. Equitable relations could be worked out.

If I might bring out another point, if you wanted to cover present Members of Congress—and I am not saying I would recommend that—for some it would be a break, because they are already paying the self-employment rate. The way that the social security system now works out, if you have both wages and self-employment income, you pay on the wages first. You could put a provision in that would take away any criticism of Members of Congress if you covered present Members. You would count their self-employment income first, and any wages that they would have would build up to the maximum taxable earnings base.

If a Member of Congress had $20,000 of self-employment income from speaking fees, based on being in effect this year, you could say that $20,000 is covered as self-employment income—just as at present—and an additional $15,700 is covered as wages as an employee.

This technically could be done. In practice, social security taxes would be withheld on congressional salary up to the maximum taxable earnings base in the year. Then, when the income tax return in filed, the self-employment rate would be paid first on all self-employment income—up to the earnings base—and the Member would receive a refund of the employee taxes paid to the extent that he or she would have paid taxes at the employee rate only on the excess—if any—of the earnings base over the self-employment income. It is different than what is done in present law, but I offer that as a suggestion.

Mr. **Conable**. Do you think the Senate would pass that?

Mr. **Myers**. I can make estimates of what will happen 75 years from now, but not on anything like that!

Mr. **Gephardt**. Thank you very much.

Mr. **Gibbons**. Mr. Martin?

Mr. **Martin**. Mr. Myers, Senator Dole raised the problem about those retirees whose income is just marginally above the threshold of $25,000 for a couple, having half of their social security benefit subjected to the personal income tax, and he recommended phasing it in. I had a concern about the extent to which that might reduce the revenues of the package. That is the second largest source of short-term savings and, by far, the largest source of long-term savings in the whole package—twice as large as anything else on the long-term saving.

If there is a justification for phasing it in, we will have a problem trying to figure out where to make up that difference.

Do you have any opinion as to what might be the proper way to resolve that problem?

It ought to be done; it is unfair for a person earning $20,000 plus one to have to pay a substantial tax and the person who is $20,000 minus one not to have to.

Mr. MYERS. I certainly feel very strongly that something has to be done about it. Notches are a terrible thing in a tax or benefit system. I am not by any means a great expert on income taxes, but I think that there are ways of solving the notch problem. If you are going to achieve the same amount of money in the aggregate out of this provision and phase it in gradually, the only thing that can be done is to lower the threshold a little.

Otherwise, if the same threshold is kept and is phased in later, it costs some money. So, I think that there are a number of technical ways of doing it that are good, but they do require lowering the threshold a little. I am not familiar enough with making cost estimates for income taxes to know how much you would have to lower the $20,000. If you had to lower it a little, this might be palatable. If you had to cut the $20,000 down to $15,000, that might be another matter.

Something must be done to stop that notch.

I am personally concerned about using only adjusted gross income. I can see a problem and some bad publicity, if people with large incomes entirely from tax-exempt municipal bonds have an annual year income of $100,000 or so and they will not pay income tax then on their social security benefits. That is going to be viewed as a great inequity, so those who have far more knowledge than I do on the tax aspects of our income tax system will probably want to look into that a little more than the Commission was able to do.

Mr. MARTIN. Another of the provisions in the recommendation from the Commission is the elimination of what is referred to as windfall benefits for persons with pensions from noncovered employment, and there is only the briefest description of what that means and no indication of how you arrive at the estimate of $200 million a year; well, $200 million over the 6-year period of savings.

Mr. MYERS. Again, this is a very desirable thing, particularly as long as there are people in noncovered employment, like the existing Federal civil servants or some State and local government employees who do get such windfalls.

I don't like the word "double-dippers". You can eliminate the windfalls in several ways. In S.1, the Senate has adopted one of the ways which I believe is excellent. There is another way that this committee has considered in the past.

The method that is used in S.1—and this was also alluded to in our report—is to say that for people who get pensions from noncovered employment, in computing their social security benefit which arises from subsidiary covered employment, the heavily weighted benefit factor of 90 percent on the first band of average earnings would not be used, but rather the 32 percent factor, which is applicable to the second band of average earnings..

In the present benefit formula, 90 percent of a small amount of earnings is payable, and 32 percent thereafter. What this method would say is that you get a proportionate benefit, 32 percent throughout. There is also a safeguard, so that people affected won't lose more than 50 percent of what their pension from noncovered employment is.

Mr. MARTIN. Wouldn't it also be appropriate to take into account the relative portion of that worker's career that was spent in uncovered employment?

Someone could work until age 65 and take civil service employment and go into private employment and work at the maximum and qualify for the maximum for the next 8 to 10 years or so, and they are getting a much better bargain, just as much a windfall as you have described, as with a neighbor who has paid in every year and only gets the same social security?

Mr. MYERS. This proposal would do that, giving them a social security benefit based on one-fourth of the time. It would be in proportion to the time that they were in covered work.

Mr. MARTIN. That they worked under covered employment.

The thing that strikes me about that, you have estimated that that would save only about $35 million a year, which says to me either that our concern has been grossly exaggerated, or that the definition of what constitutes a windfall in arriving at that computation is very narrow.

Mr. MYERS. The reason that it shows such small savings in the shorter term is because it phases in very slowly and only applies to new people. You don't go back and take the windfall benefit away from people on the rolls.

It is a fairly significant long-range savings, point one percent of taxable payroll.

Mr. MARTIN. Point zero one, it says here.

Mr. MYERS. I am sorry; that is correct, but personally I think that 0.01 percent is a little low.

Mr. MARTIN. New hires that have come in——

Mr. MYERS. You are covering all nonprofit employees compulsorily, and only the State and local employees are not covered on a permanent basis, but 70 to 75 percent of them are now covered on a voluntary basis. It is actually a little higher savings than that, I believe. At least, it is something that results in more equitable treatment.

Mr. MARTIN. What is the definition—I have seen this term used here—what is a divorced widow, someone divorced from a former spouse who is now deceased, regardless of whether they have remarried?

Mr. MYERS. Let us assume that, for a married couple, the man is the only wage earner in the family and gets divorced after 10 years. Then, that woman after the man's death is a divorced widow, and as long as she does not remarry, she can draw benefits on that deceased male wage earner.

Mr. MARTIN. She is a divorced widow when he dies.

Mr. MYERS. Yes.

Mr. MARTIN. Not before he dies?

Mr. **Myers**. No; before that, she would be a divorced spouse.

Mr. **Martin**. This would only apply to the time later on when he has expired and she would qualify?

Mr. **Myers**. That is correct.

Mr. **Martin**. Does it take into account whether or not she had remarried?

Mr. **Myers**. If she remarries, except after age 60. However, if she gets divorced at 30, after being married 10 years, and then marries again, that wipes out her rights to a widow's benefits unless the next husband dies, too. Then, she would get the larger of the two widow's benefits.

As long as she is married to another person, that wipes out those rights on the first husband. If she works in the paid labor market, and gets a larger benefit on her own, she would not draw as a divorced widow.

Mr. **Martin**. That seems fair. Thank you, sir.

Mr. **Ford**. Mr. Chairman, I have no questions at this time.

Mr. **Gibbons**. This concludes the hearing for today.

Mr. **Myers**. Could I presume that the document that I presented today will be included in the record?

Mr. **Gibbons**. Absolutely. It will be included in the record.

The committee will recess until 9 a.m. tomorrow morning.

[Whereupon, at 1:05 p.m., the committee adjourned, to reconvene at 9 a.m. Thursday, February 3, 1983.]

RECOMMENDATIONS OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

THURSDAY, FEBRUARY 3, 1983

House of Representatives,
Committee on Ways and Means,
Washington, D.C.

The committee met at 9:40 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Dan Rostenkowski (chairman of the committee) presiding.

Chairman **Rostenkowski**. Mr. Secretary, Commissioner, welcome to the committee. We are certainly happy that even in these closing days of an outstanding public career you are here to join with us in discussing the proposition that we discussed earlier this year on cost reimbursement.

I appreciate the fact that you will be able to give us your impressions of just how we can best serve our constituents, and how best we can cut spending if that has to be done.

So at that, Mr. Secretary, welcome to the committee. We are looking forward to your testimony.

STATEMENT OF HON. RICHARD S. SCHWEIKER, SECRETARY OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES, ACCOMPANIED BY HON. JOHN A. SVAHN, COMMISSIONER OF SOCIAL SECURITY; AND ROBERT J. RUBIN, M.D., ASSISTANT SECRETARY FOR PLANNING AND EVALUATION

Secretary **Schweiker**. Thank you very much, Mr. Chairman and members of the committee.

Let me say that I have always enjoyed appearing before this committee and particularly appreciate the many courtesies that you, Mr. Chairman, and the committee, have always shown me. I am a great admirer of how this committee has functioned with respect to some of the most difficult problems and issues, knowing how large it is and based on my own service in the House, and I just want to commend the chairman for being a pretty strong and effective leader on some difficult issues. I want to say that before I leave.

Chairman **Rostenkowski**. Thank you.

Secretary **Schweiker**. Mr. Chairman and members of the committee:

I appreciate the opportunity to appear before you today to discuss the financial condition of the social security program and the recommendations of the National Commission on Social Security Reform as well as our hospital prospective reimbursement proposal.

With me is Commissioner Jack Svahn who will discuss the social security reforms in more detail, and Dr. Robert Rubin who will answer questions on the hospital prospective payment system.

There is no need for me to review with this committee the urgency of the situation or the importance we attach to the restoration of the fiscal integrity and the public confidence in the social security system.

The bipartisan agreement reached by the National Commission on Social Security Reform gives us a unique opportunity to demonstrate to the people by whom we are elected and appointed to serve that the administration and the Congress can work together in a bipartisan way to deal effectively and fairly with this most critical issue.

I don't think it is possible to overstate the value of the work of the Commission in reaching agreement on the kind of legislation that is needed now to restore and maintain the viability of our social security system.

Dr. Greenspan, distinguished Members of the Congress, public citizens who served on that Commission deserve both our congratulations and our gratitude for their extremely valuable work.

One of the single achievements of the Commission is the reaffirmation of the social security's fundamental role in providing basic income after retirement, disability, or death.

It is a major step toward restoring public confidence in social security and this administration wholeheartedly concurs with this most basic conclusion of the National Commission.

Another fundamental achievement of the Commission was defining the extent of the social security financing problem. The Commission reached bipartisan agreement on the need for $150 to $200 billion in additional revenues and/or reduced expenditures in the short range and on the existence of a long-range gap between revenues and expenditures of some 1.8 percent of taxable payroll.

The bipartisan solution to the social security financing problem recommended by the National Commission, accepted by the President, the Speaker, majority and minority leaders of the House provides the compromise that is needed for quick action.

As President Reagan noted in his January 15 statement, the National Commission plan includes elements which each of us would not support if they were not part of a bipartisan compromise.

Mr. Chairman, I believe we all agree that there is no more time for rhetoric or delay, fear on the part of both retirees and younger people that social security is tottering and on the brink of collapse has been allowed to continue too long.

There has been too much frustration over the inaction and disagreement that has prevailed ever since the administration pointed out the extent of the financing problem in 1981.

However, there is a new sense of urgency, a new agreement on the need to act and a new readiness to do so and I want to commend the chairman for calling these hearings and for getting in on the track this early in the session.

We pledge to you, Mr. Chairman, our cooperation as work progresses on both the Commission's bipartisan financing package and the best way to erase the remaining long-term deficit.

The interest of 36 million beneficiaries and 116 million taxpayers cannot be allowed to fall victim to narrow viewpoints now when we are so close to restoring social security's ability to meet its commitments today and for the future.

Mr. Chairman and members of the committee, it is a distinct pleasure to be here today also to discuss with you the Department's proposal to reform the hospital reimbursement system under medicare. This plan provides a significant opportunity to achieve our mutual objectives: to encourage hospitals to provide patient care efficiently; to allow medicare to become a prudent buyer of services and at the same time to assure the quality of patient care.

Mr. Chairman, we hope this initiative will become truly a bipartisan endeavor. Your committee has been instrumental in crafting the legislation requiring a prospective payment plan and in developing the significant reimbursement changes recently enacted into law.

These interim improvements and your directions to us have paved the way for the permanent reforms we are discussing today.

Fundamental changes are needed in medicare if we are to control the rate of growth in expenditures, protect the financial stability of the hospital insurance trust fund, and preserve the integrity of the program itself.

Today, over two-thirds of all medicare expenditures are for inpatient hospital care. Therefore, a primary opportunity for these changes is the way we pay hospitals. Medicare expenditures for hospital care have averaged a 19-percent increase each year between 1979 and 1982. These increases have been especially noticeable over the past year while we slowed overall inflation to 3.9 percent during 1982.

Overall hospital costs rose over three times faster, triple, some 12.6 percent.

Congress has recognized in the Tax Equity and Fiscal Responsibility Act [TEFRA] that the medicare reimbursement system needed major structural reform to eliminate perverse incentives, and thereby to reverse the inflationary spiral in hospitals.

Recognizing the need for fundamental reform, this committee initiated the congressional mandate for development of a prospective payment proposal, a system which would establish hospital payment rates in advance of delivery of care instead of determining the cost after the care has been provided.

Now, with your permission, Mr. Chairman, if you would look to the charts on your left and my right, I would like to mention highlights of the plan that I think are probably better illustrated by charts rather than written testimony.

Chairman **Rostenkowski**. Mr. Secretary, I would like to point out to my colleagues that we have a duplicate of that.

Secretary **Schweiker**. It may be a little hard to read from back there so I am glad you do.

The main point here in the first chart is that the present system is a cost-plus system. It reminds me of World War II where we built a lot of things that we needed for defense and everybody put the profit margin in the bill and sent it to Washington in a cost-plus contract.

In many ways we are using a third-party payment system that is a cost-plus approach—very inefficient and very costly. There are no incentives for hospitals to control costs. In fact, it is ironic that we actually reward inefficient hospitals, because if they are inefficient they get paid more, so there is a negative incentive.

As I mentioned a moment ago, we have seen the impact of this numerically, 10 percent a year for hospital services increased from the last 3 or 4 years. The medicare deductible which, as you know, is sort of the index of what is happening here, has gone up 17.7 percent a year for the last 3 years. And while inflation dropped to 3.9 percent, hospital costs have increased to 12.6 percent, or triple that rate.

The next chart shows the rise of hospital expenditures under medicare.

First, let me say that my Department pays 40 percent of all the hospital bills in this country, and if you count medicare and medicaid together, about $85 billion of all health costs today are in my budget.

Now these bargraphs show what has happened to hospital costs under medicare. In 1983 you see a figure of $38 billion. The 1984 figure will jump to $44 billion, and then in 1985 it jumps to $50 billion. So it escalates tremendously in these last few years.

The next chart illustrates that medicare is not a prudent buyer of services. Medicare is one of the worst buyers in the country considering that we buy 40 percent of hospital services.

Medicare, as I mentioned a moment ago, purchased $38 billion of hospital services in 1983 and it will be $44 billion or $45 billion in the budget that we are proposing.

The real kicker is the bottom line on this chart which shows that if you go to one hospital because of a simple heart attack medicare will pay as little as $1,500, if that's what the hospital bills us.

You can go to a hospital down the street and have a simple heart attack, with the same complications, or lack of them, get the same treatment, and we will pay that hospital $9,000, no questions asked—a 6-to-1 ratio of one over the other.

The chart shows $2,100 is the low cost for hip replacements. For the same kind of treatment, the same medical device, $8,200 is what we pay another hospital. And in cataract removal it is a 7-to-1 ratio, from $450 in one case to $2,800 in another case.

Our trouble is under the medicare system, today we have no reason to challenge those disparities. Unless we can show malpractice or malfeasance or something of that nature we end up paying the full bill. That is really the problem.

The next chart shows what we believe prospective payment will do. First, it will show the hospital how much it is going to be able to spend on the treatment of a particular illness and to be governed accordingly.

It is going to reward the efficient providers in the sense that if they can provide treatment for less than a stipulated sum they keep all the money. They make a profit.

There is a capitalistic incentive in the system. It encourages hospitals to do some specialization. Now doctors specialize because they like to, but nobody specializes for economic reasons. There is no incentive.

Like any other segment of the economy, we hope this will encourage efficient providers to do the things they do best, to specialize and still maintain quality.

In addition, we are going to adjust those payments by some market basket formula that we would review each year. We would also include a technology factor so that new devices, new therapies could be cranked into the payment system.

We believe regulatory burdens would be substantially reduced because we would eliminate the present cost reporting system which hospitals have been so critical of.

The next chart shows that payment under our plan would be based upon the diagnosis of a specific disease. All diseases are assigned to diagnosis-related groups and certain subsets of those groups.

This is not a new system. It was developed over 10 years ago in a joint study with Yale University. It has been reviewed by the Public Health Service and private sector doctors. We have some 1½ million records of incidents here in some 350 hospitals that we worked with to develop.

In addition, every fifth medicare patient discharged is tabulated under a computerized MEDPAR system so that every fifth payment is sampled today on a computer and we know what the costs are. Cases ending in zero and five automatically come into our data system so this data system has been building up for well over 10 years.

The DRG rate would be a national rate but would vary by the wage adjustment for a standard metropolitan area. So a high labor rate area would have a high factor for labor. A more rural area would have a low factor for labor.

Second, we would deal with teaching hospitals by basically passing through medical education cost so that we are not going to penalize a teaching hospital because it has a lot of extra costs attributable to training people and educating new doctors.

Third, we are separating out capital costs. We do not want at this time to get into the controversy of profit versus nonprofit capitalization. At some time, we want to come back and look at capital costs, analyze them and treat them differently and we simply are not putting them in there on the first go around. They will be separate tracks.

We have diagnostic related groups on the next chart. There are some 467 different groups. Basically, the groups are based on the diagnosis for the specific diseases, and the age of the patient, because an older patient has more complications, requires more care. Other factors are on whether there is surgery or some specific medical device or apparatus used, and the discharge status of the individual.

Now, I have tried to show on the next chart exactly how this system works so that it is not quite as complicated as it first appears. Basically there are 467 diagnoses, but I think it is important to note there are only 23 major categories and they are obvious categories: the nervous system, the eye, ear, nose and throat, respiratory, and circulatory system.

On this chart, I have taken one subset, the circulatory system, and that is divided into three subgroups, hypertension, heart attack, and angina. And then if you follow the heart attack one through, you see there are four kinds of heart attacks. One is without complications, no surgery. Another requires a pacemaker. One with complications and the pacemaker and another one where the patient has died.

So there are four types of diagnoses. Each one gets a different type of reimbursement depending on the complications and the medical treatment involved.

The next chart shows one specific example. This would be DRG No. 122. There was no surgery. It was a simple attack without complications. The patient was discharged alive. This particular one might be paid a rate of $305, to give a quick illustration.

Finally, this last chart attempts to show that even though there are 467 diagnoses, the bulk of them form a hard core smaller number. If you look at this chart, 50 percent of the cases are covered by only 30 diagnoses.

In other words, 50 percent of the patients will only have 30 diseases that they are being treated for. Seventy-five percent of the patients will be covered by 83 diagnoses and that is not unwieldy. We do have a lot of others just because of many rare diseases and rare treatments that are also covered in this system.

I think it is important also to note that under this system, the sicker a patient is, the more we pay the hospital. So when hospitals come and say they are not getting paid fairly because they have the tougher patients, they have the heavier caseloads and all the bad patients that nobody is going to take, our response is that we are are going to pay more for those patients.

I think it is very important to understand this. When we first sat down and talked with the public hospitals, this was a very important point because they felt they were being dumped on. We said public hospitals have these advantages: First, is we pay more money if you have sicker patients. So if you take a sicker patient, you will get a lot more money than the hospitals that don't do that.

Second, we have something we call an outlier situation. We know there are always exceptions to the rule. Somebody will stay in the hospital for 6 months and they may not fall into that neat category.

These people we call outliers because they lie outside of the normal curve.

We will have exceptions procedures for outliers. So where a patient is extremely sick and has a lot of complications, and doesn't neatly fit into a category and may be in the hospital for 3 or 4 months, we will pay that hospital an outlier fee for that patient.

So if a small hospital has a patient who stays for, say 6 months, or a big town public hospital has five or six of these because nobody else wants them—we are going to pay them for them.

I think it is important to know that we have a chance to maintain the quality of care here because we are going to pay more for sicker patients.

That is why I rejected another prospective payment system based on a per capita fee. We thought that was a sure invitation to skim—to get, say, $1,000 per patient and take all the mild cases and dump all the serious ones on the big hospitals and make a profit.

Under our plan you make a profit by taking sicker patients because you get paid more money.

I think it is awfully important to make that distinction.

Finally, let me close with just a few more words on the total picture, Mr. Chairman. The changes in the TEFRA that Congress passed last year represent an important interim improvement in the current system. However, even they do not provide sufficient incentive for hospitals to keep their costs below the limit. Thus TEFRA does not alter the fundamental nature of retrospective payment, payment after the fact, nor does it eliminate the incentives which we believe reward increased spending by hospitals.

The provisions in TEFRA have laid the groundwork for major reform, a viable prospective payment system in several ways.

First, TEFRA provided incentives for efficient hospital management as well as penalties for inefficiencies and thus it established the concept that the payment system should reward the efficient and penalize the inefficient.

Payments also are on a per case basis, rather than paying hospitals for each day of care which we believe encourages a hospital to keep patients longer than they might. Each hospital's payment is adjusted to refect the different kind of patient it usually treats, its caseload, recognizing for the first time the need for such a case mix adjustment in the hospitals payment system.

In recognizing the interim nature of the TEFRA provisions, this committee included a requirement that the Department develope a perspective payment proposal. On December 28, in keeping with the deadline you imposed, I presented that report to you.

The Department's proposed prospective payment system has these basic elements. Hospitals will be paid on the basis of output. We propose that hospital payment be set on a per-discharge basis based on the specific diagnostic characteristics that I just explained.

Two, hospitals in a geographic area will be paid the same rate for the same service, thus we could eliminate the situation I talked about where a hip operation in the same area generates a $100 bill from one hospital and an $8,400 bill from another one, with no difference in quality.

Payment rates will cover all operating costs. Additionally, medical education costs would not be included in the rate. They would be treated as they are under current law. Finally, special provisions will be made for cases with extraordinary lengths of stay, the cases I referred to as outliers.

The system covers short-term general hospitals. Because of the special problems and characteristics of long-term care hospitals, psychiatric and children's hospitals we do not include those facilities in the prospective system at this time. We would consider adding them at a later date; meanwhile, they would be paid for services as under current law.

I think it is very important for sole community providers to assure that beneficiaries have access to care. We recognize that in some areas competition will be generated and that should increase efficiency. Some areas, however, particularly rural areas, may have only one provider. So we are going to have a provision where a sole community provider may get paid under the older system so that nobody will be denied access, because some rural hospitals can't measure up to the competition for the urban rate where there may be five or six hospitals competing.

It is very important to understand that there is an exemption procedure for sole-source providers.

That is a very fundamental part of this concept.

Now, there are some specific issues that are raised under this concept. I already mentioned medical education in addition to patient care in teaching hospitals, these hospitals are training 70,000 residents. They will be given special treatment, as I mentioned. They will not be solely limited to the DRG payment. This function, we believe, is very important.

One approach for payment of teaching costs is to use the same method we now use in implementing section 101 of TEFRA. Direct costs associated with medical education, specifically resident and faculty salaries, are given a passthrough. Another formula is used to calculate a special payment for indirect costs involved in medical education. These are all the unmeasurable costs associated with teaching.

We are going to do further study of this area and we might refine and perfect our approach in the future. We anticipate that more study of this will allow the department to develope better methodology later on.

Another issue is capital-related costs which include depreciation, interest, rent, leasing and similar expenses. These costs only represent 6 percent of a hospital's cost, by the way.

We will put capital-related costs on a separate track. We plan to do nothing now, but we reserve the right to present to the Congress later a plan for dealing with this situation.

Quality of care is another issue I would like to address. You have expressed an interest in how the prospective payment will impact on medicare beneficiaries. Let me assure you we will do everything we can to maintain our commitment to high quality care. I think the fact we are paying more money for sicker patients, the fact we have a special payment for outliers, and the fact we have a sole community provider exemption will help insure that we maintain quality of care in the system.

In fact, we believe the prospective payment system may enhance the quality of care, because we believe it encourages specialization and hospitals will become efficient and specialize in what they are good at. Most studies have shown that as hospitals specialize in certain services, the quality of the care actually improves.

One indirect benefit we hope to achieve in this system is the reduction of paperwork and reporting requirements on the hospital. At least 25 percent of the reporting requirements will be eliminated and that ought to approach about 5 million burden-hours per year.

In conclusion, Mr. Chairman, I believe that prospective payment is a necessary step in our effort to establish appropriate economic incentives in the medicare program and to establish the Federal Government as prudent buyer of services.

We look forward to working with you on this important initiative.

Thank you very much.

[The prepared statement follows:]

Statement of Richard S. Schweiker, Secretary of Health and Human Services

Mr. Chairman and members of the Committee, I appreciate the opportunity to appear before you today to discuss the financial condition of the Social Security program and the recommendations of the National Commission on Social Security Reform.

There is no need for me to review with this committee the urgency of the situation or the importance we attach to the restoration of the fiscal integrity and public confidence in the Social Security system. After 2 years of intense debate, there is now much better public understanding of both the nature of the Social Security program as a pay-as-you-go system and of the fundamental issue of Social Security benefit expenditures exceeding Social Security revenues. I think it's fair to say that the American people are now convinced that the administration was correct in warning of the exhaustion of the OASI trust fund (which occurred November 5, 1982) and agree with the need for getting on with the job of restoring financial soundness. More than that, of course, the people are concerned—even fearful—about the financial soundness of Social Security and impatient and frustrated over the inaction, indecision, and partisan posturing that they have seen up to now.

The bipartisan agreement reached by the National Commission on Social Security Reform gives us the opportunity to demonstrate to the people whom we are elected and appointed to serve that the administration and the Congress can work together to deal effectively and fairly with this most critical issue. I don't think it is possible to overstate the value of the work of the Commission in reaching agreement on the kind of legislation that is needed now to restore and maintain the viability of our Social Security system. Dr. Greenspan and the distinguished members of Congress and public citizens who served on that Commission deserve both our congratulations and our gratitude for their extremely valuable work.

One of the signal achievements of the Commission is the reaffirmation of Social Security's fundamental role in providing basic income after retirement, disability, or death. It is a tribute to the enduring vitality of the principles of Social Security that national leaders of business, industry, labor and the Congress representing a wide spectrum of viewpoints could all agree on the fundamental soundness of the Social Security approach. It is a major step toward restoring public confidence in Social Security. This administration wholeheartedly concurs with this most basic conclusion of the National Commission.

Another fundamental achievement of the Commission was defining the extent of the Social Security financing problem. The Commission reached bipartisan agreement on the need for $150 to $200 billion in additional revenues and/or reduced expenditures in the short range and on the existence of a long-range gap between revenues and expenditures of some 1.8 percent of taxable payroll. While these numbers are, of course, sensitive to changes in the economy and to long-range economic and demographic assumptions, they underscore the seriousness of the situation we face. The Commission not only confirmed the undeniable reality of the Social Security financing problem but also showed that at last there is a consensus that the time has come to deal with this problem. They also set an example for us all in showing that in the interest of the broader objectives of restoring the soundness of the system, we may each have to accept some measures that we are less than enthusiastic about. The Commission's Bi-Partisan Financing Solution is a carefully balanced compromise, every piece of which was critical to achieving agreement. The administration recognizes this, and that is why we have endorsed the package despite the fact that it contains provisions we could not have supported individually. The reality of the situation is that something must be done, and it has become clear that we all must be realistic in compromising on a solution.

Mr. Chairman, both the problems we face and the solutions we are considering are the result of forces that have been at work for 10 years now—10 years of nearly continuous crisis in Social Security financing, and 10 years of rising public doubts about the soundness of Social Security. To put our current situation and the Commission's recommendations in perspective, let me review for the record the recent history of Social Security financing.

HISTORY OF RECENT FINANCING

In 1970, the OASDI trust funds had more than 12 months' worth of benefits on hand, and financing projections showed continually favorable financial conditions for Social Security.

By 1973, however, the Board of Trustees of the OASDI trust funds began to project both short-term and long-term financing problems. The projected situation worsened annually thereafter as developing experience proved more adverse than expected and the long-range assumptions were revised. By 1977, the trustees reported a crisis in the short range and a long-range gap between expenditures and revenues of nearly incredible dimensions—8.2 percent of taxable payroll.

In response to these reports, the Congress took courageous action in 1977 by both reducing future benefit growth and increasing Social Security tax revenues. The most far-reaching benefit reductions in the 1977 amendments corrected a major flaw in the automatic benefit adjustment formula and reduced some of the unintended increase in replacement rates which took place in the 1970's. These changes reduced the benefit for a person with average earnings retiring at 65 in 1983 by up to 25 percent compared to what it would have been had the flawed formula remained in effect. The 1977 amendments also increased Social Security taxes by over $400 billion between 1979 and 1990, due primarily to six increases in the combined OASDHI tax rate.

It is important to bear in mind that intermediate economic assumptions were used to project the results of the 1977 amendments. Those projections showed adequate funds to meet benefit payments in the cash benefits programs until sometime beyond the year 2025. But economic assumptions that seemed reasonable at the time proved wrong. Beginning with 1979, economic performance has been substantially worse than even the pessimistic assumptions made in 1977. Thus, by 1980 Social Security was once again facing a financing crisis.

This time the Congress responded, in October 1980, with a temporary measure: a reallocation of revenues from the DI program to the OASI program for calendar years 1980 and 1981. However, the Social Security financing crisis worsened, and further action became necessary sooner than expected.

In an effort to obtain more time to consider effective short- and long-term solutions to the system's financing difficulties, the Congress in 1981 authorized interfund borrowing among the OASI, DI and HI trust funds, with any such loans repayable with interest. Borrowing was authorized only in amounts sufficient to ensure that benefits could be paid through June of 1983.

The interfund borrowing authority has been used three times: $581 million was borrowed by the OASI trust fund from the DI trust fund on November 5, 1982; $3.4 billion was borrowed by the OASI trust fund from the HI trust fund on December 7; and $13.5 billion was borrowed by the OASI trust fund from the DI trust fund ($4.5 billion) and HI trust fund ($9.0 billion) on December 31, 1982.

Since the borrowing authority has expired, the OASI program will, in the absence of further legislation, be unable to pay retirement and survivor's benefits on time beginning in July 1983.

Mr. Chairman, in reviewing the history of the last 10 years in Social Security financing, what stands out clearly is the sensitivity of Social Security to economic factors, and the need to better guarantee the soundness of the program in the event that developing experience is less favorable than all the experts' best guesses at the time the Congress acts.

CAUSES OF CURRENT FINANCING PROBLEMS

Recent history has also vividly illustrated the basic causes of the current short- and long-range financing problems faced by the Social Security program:

Having benefit expenditures determined by inflation rates while revenues are determined by wage growth and employment levels; and long-range demographic shifts which affect the ratio of working people to beneficiaries.

In recent years, cost-of-living increases as measured by the Consumer Price Index have exceeded increases in average wage levels. As a result, annual COLA's have caused benefit expenditures to increase at a faster rate each year since 1978 than the tax income on earnings covered by Social Security.

It is estimated that each 1-percent increase in the unemployment rate directly reduces Social Security tax income by about $1.8 billion and that secondary effects of high unemployment, such as reduced hours for many of those still employed, may reduce tax revenues by that much again. In addition, high unemployment may tend to encourage individuals to seek retirement or disability benefits sooner than they otherwise would, putting additional pressure on the trust funds.

In addition to economic performance, which affects both short- and long-range Social Security financing, demographic factors strongly influence the long-range financing situation. As you know, it is expected that some 50 years from now, the Nation will have a relatively larger older population as the post-World-War-II "baby boom" ages and as the work force continues to reflect the low fertility rates since the 1960's.

At current retirement ages and retirement rates, this would mean that there would be a large retired population being supported by a smaller relative number of workers than at present, continuing low-birth rates and increases in life expectancy mean that while the total population grows by about 40 percent over the next 50 years, the population aged 65 and older will increase by about 150 percent. Growth in the very oldest portion of the population will be greater still—it is estimated that the number of people 85 and older will triple. Thus, not only will there be more retirees collecting benefits in the next century, they will be collecting them for longer periods than ever before.

SCOPE OF PROBLEM

As the National Commission on Social Security Reform has shown in its work, Mr. Chairman, any effort to restore the financial soundness of Social Security must begin with agreement on the scope of the financing problems. I will first look at the short-range financing need, which is, of course, the most pressing concern today.

In addressing the short-range situation, it is important to consider not only meeting the immediate benefit obligations but also providing for a measure of public confidence by maintaining some operating and contingency reserve levels in the trust funds.

Two primary factors determine the amount of additional financing needed by the system in the short run: The appropriate reserve ratios to be maintained by the system and the economic assumptions used. The question of the appropriate reserve ratios to be maintained by the system is, to some degree, a matter of judgment. Fifteen percent is the lowest possible annual reserve level for the OASDI trust funds. Although 8–9 percent is the absolute minimum reserve ratio needed to pay each month's benefits on time, the fluctuations in income and outgo that occur in any year require an additional 5–6 percent to smooth out the month-to-month variations. In view of recent experience, even the 15-percent level could involve some risk. Building up to a 25- to 30-percent level over the next few years would be more prudent.

Choosing which economic assumptions to use to determine the system's short-range financing needs is much more difficult and fraught with uncertainty than choosing a reserve ratio target. Although we are hopeful that economic performance improves in the coming months and years, projections assuming rapid improvement should not, as a practical matter, influence decisions regarding the Social Security program. We have been stung too often by the use of estimates that later proved too optimistic. We cannot base the financing of Social Security on hopes (or even on reasonably favorable expectations). If our expectations for improved economic performance are realized, whatever measures we have taken will result in an even stronger Social Security system.

In 1982 Trustees' Reports projected a long-range deficit in the OASDI program of 1.82 percent of taxable payroll, based on the trustees' intermediate assumptions. In other words, over the 75-year valuation period, the average cost of the program exceeds the average payroll tax rate in the law by an average of 1.82 percent per year. The lower than projected cost-of-living increase last July and the 1982 Tax Equity and Fiscal Responsibility Act reduced the estimated OASDI long-range deficit to 1.80 percent of taxable payroll. However, revised assumptions for the 1983 Trustees' Report reflecting both the low birth rate and lack of real wage growth in recent years are expected to show a long-range deficit greater than 1.80 percent of taxable payroll.

The question of how close an actuarial balance should be maintained in the Social Security program over the 75-year valuation period is one that has received considerable attention over the past few years. I should emphasize, particularly in light of recent economic experience, that estimates made for a dynamic system with automatic cost-of-living features over a period of as long as 75 years must necessarily be considered rather tentative projections instead of precise predictions.

We believe that the Congress should take into account the great erosion in public confidence in the financial condition of the Social Security program that has occurred in recent years. It may well be advisable at this time to strive for something close to a 75 year actuarial balance.

SOLUTION RECOMMENDED BY NATIONAL COMMISSION

The Bi-Partisan Solution to the Social Security financing problem recommended by the National Commission and accepted by the President, the Speaker and the

Majority and Minority Leaders of the House provides the compromise that is needed for quick action. As President Reagan noted in his January 15 statement, the National Commission plan "includes elements which each of us could not support if they were not part of a bi-partisan compromise."

I am sure that none of us likes every proposal in the National Commission package; none of us would support every one on an individual basis. The difficulty is that there is no solution to the problem that everyone would like. The package developed after intense negotiation by the National Commission represents a carefully balanced effort to achieve a solution that can be accepted by the American people as a fair method of putting Social Security on a sound financial basis.

The Commission's package adequately addresses the short-range problem and goes a long way toward erasing the long-range problem. The overwhelming need to reinstill confidence in Social Security's ability to meet its commitments to future generations of retirees makes it imperative that we complete the work of eliminating the projected long-run deficit. The National Commission suggested two means of accomplishing this:

Beginning in 2003, gradually raise the current age of 65 for full retirement benefits to 66 beginning in 2014; or

Beginning in 2010, increase the OASDI tax rate on employees and employers each by 0.46 percent.

A majority of the Commission recommended the first approach, gradually raising the current age of retirement.

There are important considerations regarding each of these suggestions. Raising the retirement age has been discussed for almost a decade as a way of offsetting the projected growth in the ratio of retirees to workers. After the turn of the century, raising the retirement age could be justified, in part, by the fact that people tend to live longer today than when 65 was selected as the retirement age in 1935 and life expectancy is expected to increase further in the future, Thus, even if the retirement age were increased 1 year 30 years from now, the average retiree could still expect to have more leisure years than earlier generations.

The only advantage of increasing Social Security taxes in 2010 to erase the long-term shortfall is that it would make unnecessary any modification of benefit amounts or eligibility. It would, however, further burden today's young workers and future generations of workers for whom Social Security will not be the bonanza it is for today's retirees.

NEED TO RESTORE FINANCIAL STABILITY

Mr. Chairman, I believe we all agree that there is no more time for rhetoric or delay. Fear on the part of both retirees and younger people that Social Security is tottering on the brink of collapse has been allowed to continue too long. There has been too much frustration over the inaction and disagreement that has prevailed ever since the administration pointed out the extent of the financing problem in 1981. Now, however, there is a new sense of urgency, a new agreement on the need to act and a new readiness to do so.

We pledge to you our cooperation as work progresses on both the Commission's bipartisan financing package and the best way to erase the remaining long-term deficit. The interests of 36 million beneficiaries and 116 million taxpayers cannot be allowed to fall victim to narrow viewpoints now when we are so close to restoring Social Security's ability to meet its commitments today and for the future.

SSI PROGRAM CHANGES

Now, at the request of Chairman Ford, I would like to address two proposed changes to the SSI program, one recommended by the National Commission on Social Security Reform and the other included in the President's budget.

As part of its recommendation to delay the Social Security COLA until January 1984, the National Commission recommended that Social Security beneficiaries who also receive SSI benefits have an additional $30 of Social Security benefits disregarded in the determination of their SSI benefit amount. This would, in effect, increase SSI payments by $30 in July for 2 million people who receive both Social Security and SSI benefits.

The disregard of Social Security benefits is not a new idea. There has always been a special disregard in the SSI program, primarily designed to make sure that Social Security beneficiaries who also get SSI benefits receive a higher amount than those who only receive SSI. This special advantage is intended to recognize that Social Security benefits are based on work and that Social Security taxes were paid.

This proposed change in the SSI disregard is part of the bipartisan National Commission agreement, and as such, we support it.

Postponement of the SSI COLA for 6 months parallels the National Commission's recommendation with respect to the Social Security COLA and is proposed as part of a Government-wide postponement of increases in indexed Federal benefit programs. This postponement must be considered in the context that all must share in the efforts to control Federal expenditures and reduce annual deficits that are essential to return to a healthy economy. When economic recovery is fully underway, the needy will benefit as well as everyone else. Indeed, to the extent that inflation has already been brought under control, any hardship due to this delay will be eased. Also, the additional $30 disregard proposed by the National Commission will help many of the SSI recipients until the COLA is paid in January.

Further, I would emphasize the importance of maintaining the tie in present law between the Social Security and SSI COLA's. Having both increases occur at the same time—next January—avoids having SSI benefits jump in July because of the SSI COLA and then drop in January to take account of the increase in Social Security benefits. Also, if both increases do not occur at the same time, some people would be eligible for SSI for July through December because of the July SSI increase, and then become ineligible for SSI in January because of the Social Security increase. And this could be repeated every year.

This lack of coordination would lead to beneficiary misunderstanding as well as place an added burden on the Social Security Administration's computer system and field offices. This unnecessary confusion and added administrative complexity should be avoided.

PROSPECTIVE PAYMENT PROPOSAL FOR MEDICARE

Mr. Chairman, you have also asked that I describe the Department's proposal to reform the hospital reimbursement system under Medicare.

First, I would like to acknowledge this Committee's important contribution to the statutory requirement for a prospective payment plan and in adopting significant interim reimbursement changes enacted into law as part of the Tax Equity and Fiscal Responsibility Act of 1982. These measures have paved the way for the permanent reforms we are discussing today.

BACKGROUND

Fundamental changes are needed in Medicare if we are to control the rate of growth in expenditures, protect the financial stability of the Hospital Insurance Trust Fund and preserve the integrity of the program itself.

Today, over two-thirds of all Medicare expenditures are for inpatient hospital care. During 1979-1982, Medicare expenditures for these services increased at an average annual rate of 19 percent. In this past year, we slowed overall inflation to 3.9 percent—and overall hospital costs rose over three times faster—12.6 percent.

A basic reason for past rapid cost increases is the way we pay hospitals. The traditional Medicare retrospective cost-based system of reimbursement provides incentives for hospitals to spend—not to constrain costs.

Congress has recognized in the Tax Equity and Fiscal Responsibility Act (TEFRA) that the Medicare reimbursement system needs major structural reform to eliminate these "perverse" incentives and promote efficiency. This legislation mandates development of a prospective payment proposal which would establish hospital payment rates in advance of the delivery of care, instead of determining the cost after the care has been provided.

OBJECTIVES OF A PROSPECTIVE PAYMENT PLAN

In formulating a prospective payment plan, we believe a new system should:

Establish the Federal Government as a prudent buyer of services and enhance our ability to predict Federal expenditures;

Ensure that hospitals can predict their Medicare revenues;

Provide incentives for hospital management flexibility, innovation, planning, control and efficient use of hospital resources;

Be easy to understand, simple to administer and be one which can be implemented quickly;

Reduce the cost reporting burden on hospitals;

Limit beneficiary liability to coinsurance and deductibles established by law and assure beneficiary access to appropriate quality care; and

Assure that Medicare expenditures for inpatient hospital services are no greater than the amount that would be spent if the present system of reimbursement, with TEFRA limitations, were continued.

TEFRA COST PROVISIONS

Before elaborating on our prospective payment proposal, it is important to note that, until enactment of the interim changes of section 101 of TEFRA, significant incentives for cost constraint within the Medicare reimbursement system were not applied.

This new authority extends the scope of the limits on allowable costs paid to hospitals for the care of Medicare patients to include the cost of ancillary services, which account for about half of today's hospital bills. In addition, the TEFRA provisions limit the amount by which a hospital's reimbursement can be increased each year.

These changes in TEFRA are important improvements in the current system, but they do not provide sufficient incentive for hospitals to keep their costs below the limit. TEFRA neither alters the fundamental nature of retrospective cost-based reimbursement nor eliminates the incentives which reward increased spending by hospitals.

In recognition of the interim nature of the TEFRA provisions, this Committee adopted an amendment requiring that the Department develop a prospective payment proposal. Congress passed that amendment, and, on December 28, 1982, I presented a report to the Congress outlining our proposal.

In developing this report, we examined numerous methodologies which could be used as the basis for a prospective payment system, drawing upon the knowledge obtained from extensive research on hospital reimbursement and State prospective payment demonstrations. The alternatives are discussed in detail in the Department's report.

THE DEPARTMENT'S PROSPECTIVE PAYMENT PROPOSAL

The Department's proposed prospective payment system has five primary elements:

Hospitals will be paid on the basis of output: Hospital payment will be set on a per-discharge basis, based on the specific diagnosis and characteristics of the patient;

Hospitals in a geographic area will be paid the same rate for the same service: At present, for example, payments for hip replacements can vary from $2,100 to $8,400, with no difference in quality. Payment rates will recognize existing differences in area wage costs, but all hospitals in an area will receive the same payment for the same service;

Payment rates cover all operating costs: Initially, capital and medical education costs would not be included in the prospective rate, but would be paid separately;

Special provisions will be made for cases with extraordinary lengths of stay;

The system covers short-term general hospitals. Long-term care hospitals, psychiatric and children's hospitals would not be included at this time. They would be paid for services as under current law. Special provisions will be made for sole community providers to assure beneficiaries' access to care. These elements will be reviewed carefully in the development of a draft bill by the administration.

PROSPECTIVE PAYMENT ISSUES

At this point, let me describe the system we propose—and address some of the major issues which have been raised.

Payment per discharge: We propose to set a payment rate for each specific type of discharge. Since patients have different diagnoses and treatment, are of different ages and differ in other ways, it is important for a payment system to explicitly reflect these differences.

To do so, we must classify and categorize patients on a per-discharge basis. The Department proposes to classify discharges using diagnosis-related groups, or DRG's, for this purpose. This classification system was originally developed at Yale University in the early 1970's and has been extensively tested and used in New Jersey, Maryland and other States—and to adjust for case mix under TEFRA.

The system includes 467 separate DRG's, which were developed by a panel of physicians. Diagnoses were initially allocated to 23 major diagnostic categories based on the body system affected.

Each category was further subdivided according to: Specific principal diagnosis; type of surgery; complications; other medical problems; and patient age.

A nationally representative sample of 1.4 million patient discharge records at 325 hospitals was used to assure that clinically related diagnoses utilized similar resources and could thus be expected to incur similar costs.

Use of the DRG's is a method for classifying patients in order to reflect differences in the cost of treatment. The Department has concluded that the DRG system is the only currently available methodology which can be easily used for prospective payment under Medicare.

The major advantages of the DRG's are that they cover the entire patient population, conform to the actual delivery of inpatient care and group cases together which are similar clinically and in use of resources.

Payment Rates: Rates will be set for each of the 467 different DRG's, and hospitals will be paid based upon the DRG of each patient. More complex cases, such as kidney transplants, will receive much higher payments than simpler cases like hernia repair. Cases with complications will receive higher payments than cases without complications.

Specifically, the payment rates would be set in the following manner:

1. Using data from the Medicare cost reports and a sample of Medicare patient records, we will determine the relative cost of each DRG;
2. The national average Medicare cost per discharge will be determined from the Medicare cost reports;
3. The two elements of information will be combined to create a price for each of the 467 DRG's;
4. A localized payment rate will be created by adjusting the national standard DRG prices for local variations in labor-related costs by applying a wage index. This provides hospital DRG price schedules for each Standard Metropolitan Statistical Area (SMSA) and each non-SMSA part of a State.

Impact on Beneficiaries: Mr. Chairman, you indicated the Committee's particular interest in the impact of our proposal on Medicare beneficiaries.

First, let me say that a prospective payment system will enable us to maintain our commitment to high quality hospital care. While quality of care is difficult to define precisely, a major Department-sponsored evaluation of State prospective payment systems has shown no deterioration in the quality of care offered by hospitals in those States.

In fact, our prospective payment proposal may enhance the quality. This system should encourage hospitals to specialize in those types of cases which they can treat efficiently and effectively. Most studies have shown that, as hospitals specialize in providing services, the quality of care improves. This is because some procedures require a high volume of cases to maintain proficiency in treatment. In addition, certain unnecessary services, some of which do not improve patient health, might be eliminated as hospitals and physicians have strong incentives to provide care more efficiently.

Finally, as I indicated earlier, beneficiary liability will be limited to coinsurance and deductibles established by law. The change in methods of hospital payment would not result in any changes in beneficiary out-of-pocket payments.

CONCLUSION

In conclusion, Mr. Chairman, I believe this plan provides a significant opportunity to achieve our mutual objectives: to encourage hospitals to provide patient care efficiently; to allow Medicare to become a prudent buyer of services; and at the same time to assure the quality of patient care.

COST-BASED REIMBURSEMENT—A "COST-PLUS" APPROACH

Hospitals lack incentive to control costs. Hospitals are paid whatever they spend.

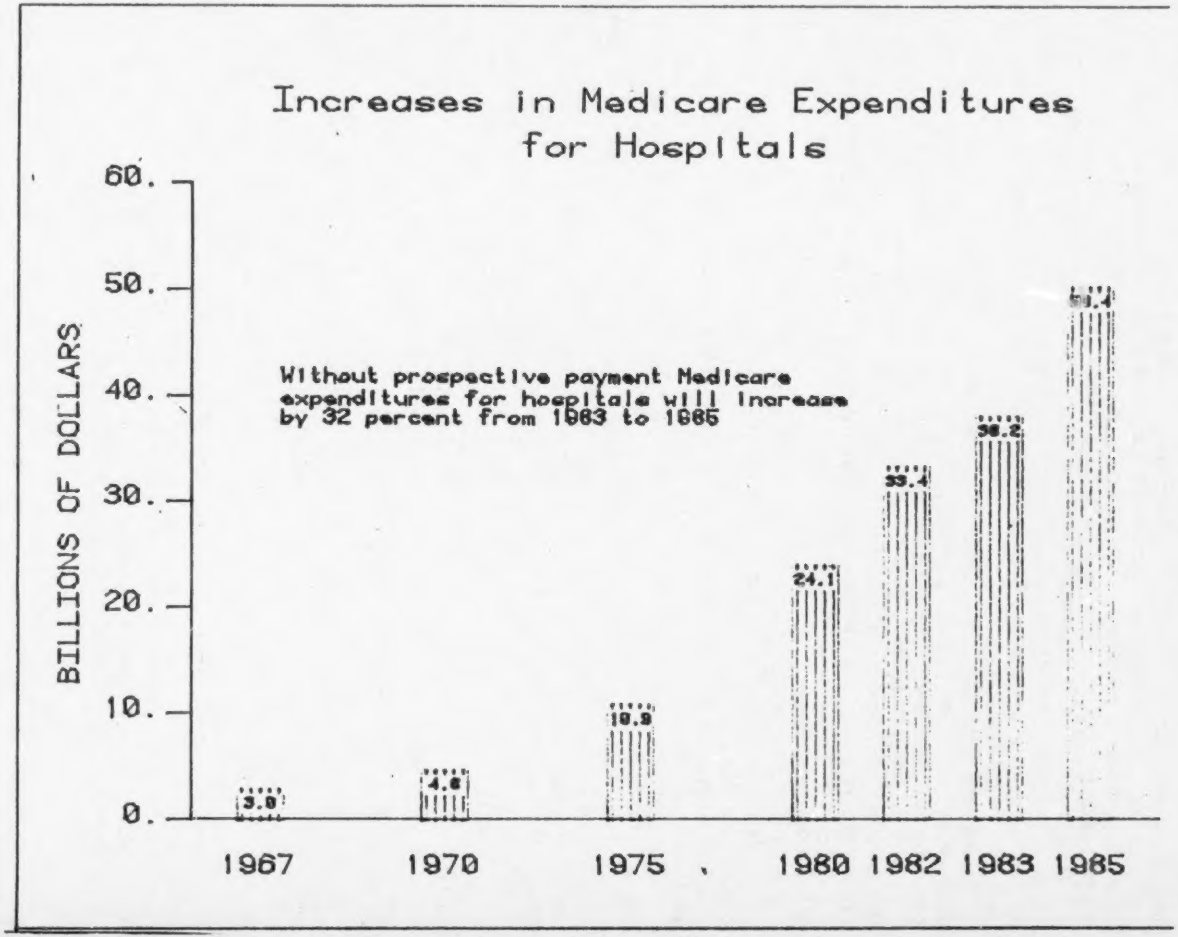
There is no reward for efficient delivery of care. Less expensive hospitals are not rewarded for good performance.

Hospital expenditures show rapid increases.

Medicare expenditures for hospital services have increased 19.2 percent per year from 1979–1982.

The Medicare deductible which measures the average cost of a day of hospital care increased 17.7 percent per year from 1979–1982.

During 1982 inflation in hospital costs increased three times faster than the overall inflation rate—12.6 percent vs. 3.9 percent.


Increases in Medicare Expenditures for Hospitals
Without prospective payment Medicare expenditures for hospitals will increase by 32 percent from 1983 to 1985
BILLIONS OF DOLLARS
60.
50.
40.
30.
20.
10.
0.
3.0
4.8
10.9
24.1
33.4
38.2
50.4
1967
1970
1975
1980
1982
1983
1985

MEDICARE AS PRUDENT BUYER

Medicare will purchase $38 billion of hospital care in 1983.

Medicare's payments for treating a heart attack can average $1,500 at one hospital and $9,000 at another hospital with no apparent difference in quality.

Medicare payments for hip replacement can vary from $2,100 to $8,200.

Medicare payments for cataract removal can vary from $450 to $2,800.

PROSPECTIVE PAYMENT

Provides hospitals an incentive to control costs. Hospitals know how much they will be paid for treating a patient in advance.

Rewards for efficient delivery of care. Hospitals that operate efficiently will retain surplus—A management incentive.

Encourages hospitals to do what they do best in certain specialties—Economic specialization.

Limits payment increases. Increases are limited to adjustments for cost of living and an allowance for new technology.

Reduces regulatory burden on hospitals. Medicare cost report virtually eliminated.

PAYMENTS TO HOSPITALS

Patients are categorized into specific groups based on diagnoses: diagnosis related groups—DRGs.

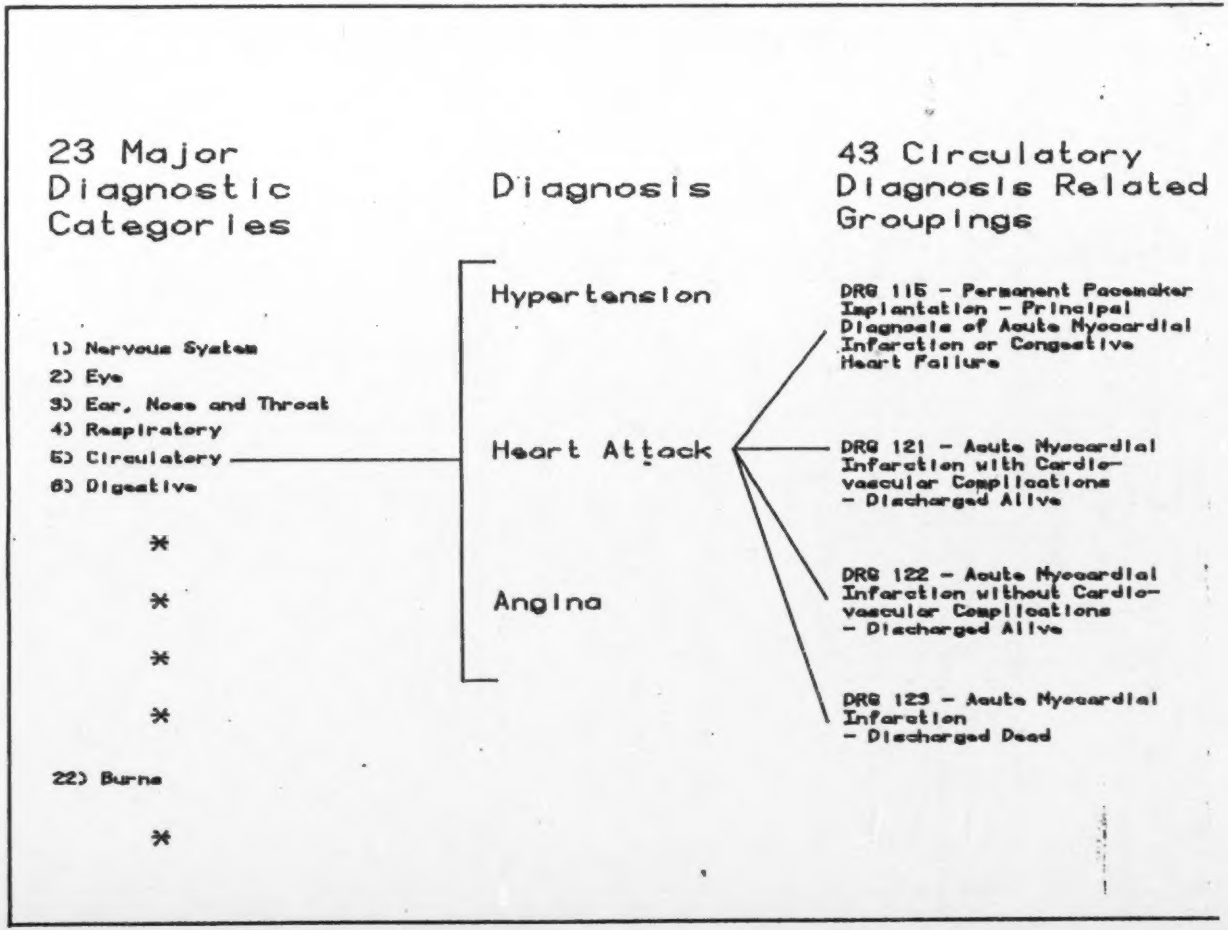
Refinement of DRGs achieved over 10 years through major HCFA research and demonstration program with Yale University.

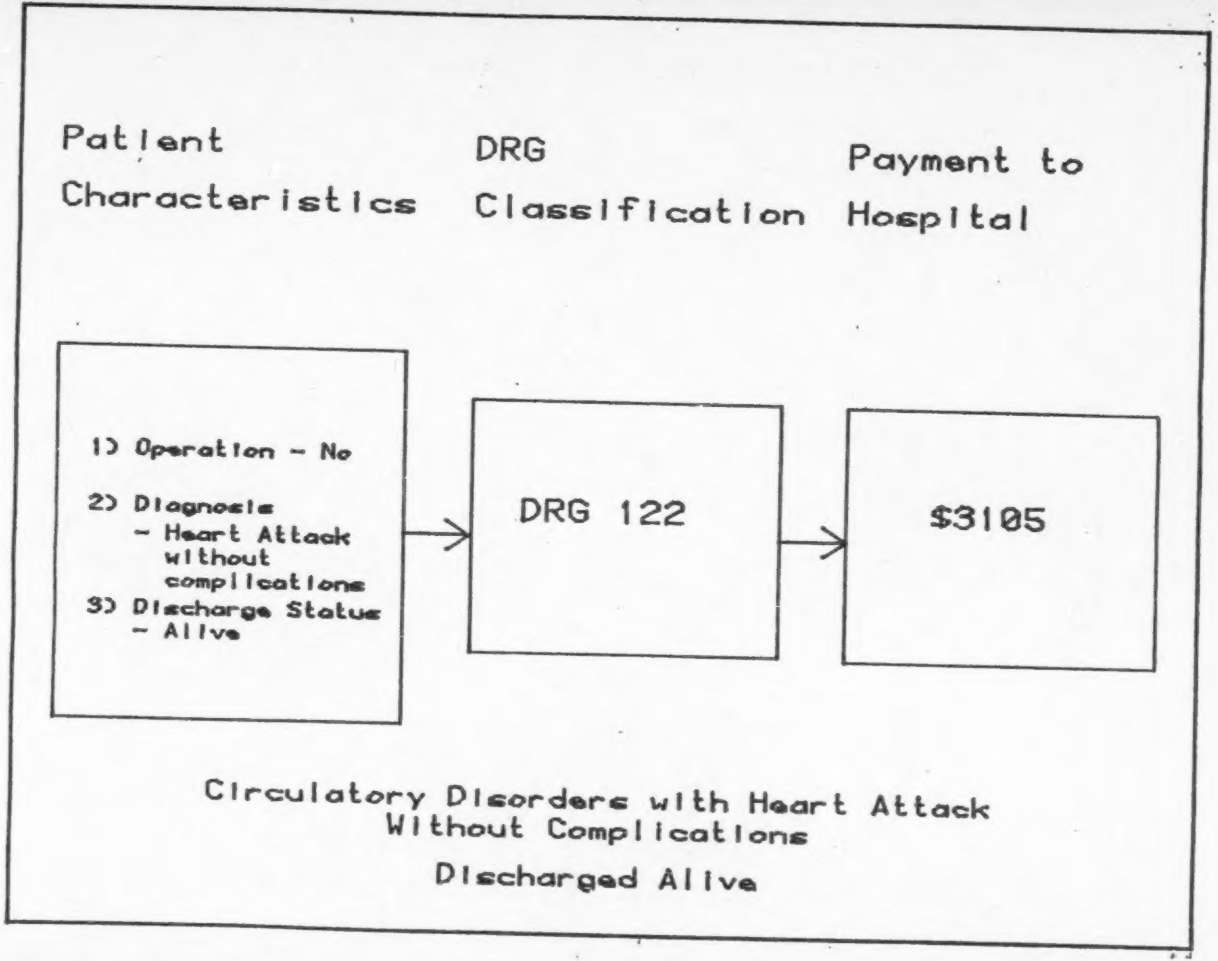
Payment rates depend on discharge diagnosis plus hospital-specific adjustment formula: wage rates in the area; teaching costs; capital costs.

DIAGNOSIS RELATED GROUPS

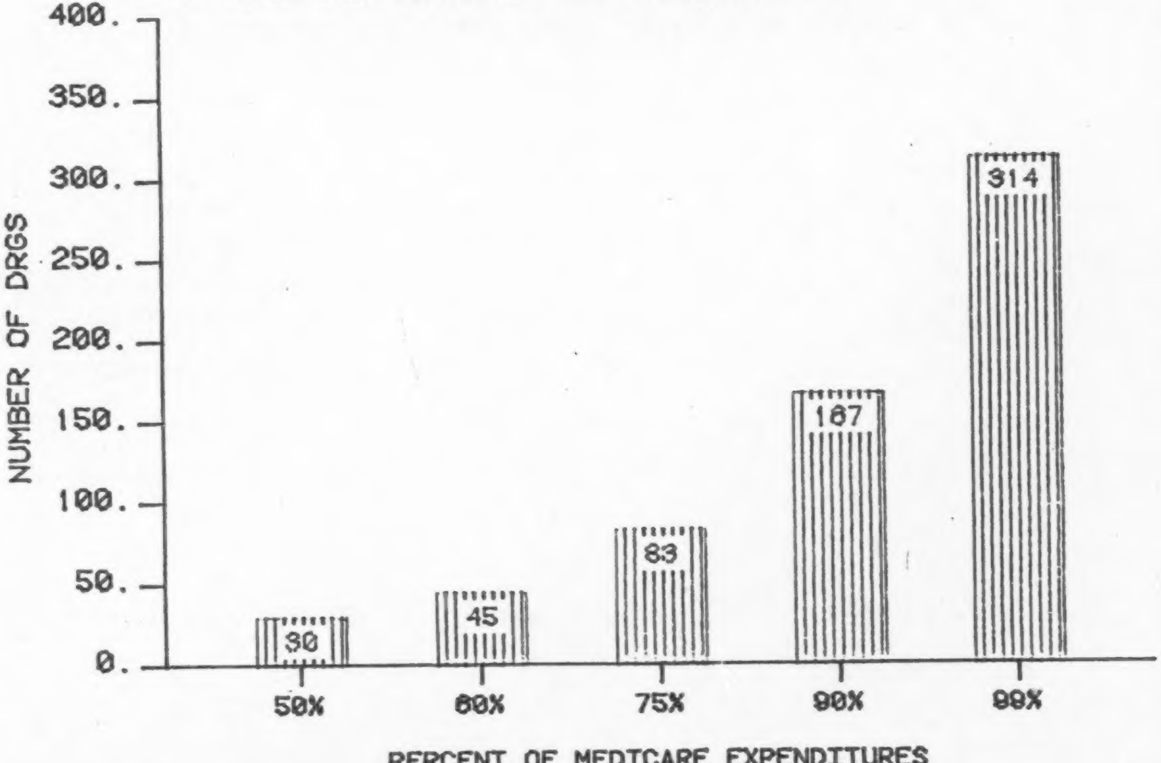
Patients classified into 467 groups.

Classification based on: patient diagnoses; patient's age; procedure utilized for treatment; discharge status.


23 Major Diagnostic Categories
1) Nervous System
2) Eye
3) Ear, Nose and Throat
4) Respiratory
5) Circulatory
6) Digestive
*
*
*
*
22) Burns
*
Diagnosis
Hypertension
Heart Attack
Angina
43 Circulatory Diagnosis Related Groupings
DRG 115 - Permanent Pacemaker Implantation - Principal Diagnosis of Acute Myocardial Infarction or Congestive Heart Failure
DRG 121 - Acute Myocardial Infarction with Cardiovascular Complications - Discharged Alive
DRG 122 - Acute Myocardial Infarction without Cardiovascular Complications - Discharged Alive
DRG 123 - Acute Myocardial Infarction - Discharged Dead


Patient
Characteristics
DRG
Classification
Payment to
Hospital
1) Operation - No
2) Diagnosis
- Heart Attack
without
complications
3) Discharge Status
- Alive
DRG 122
$3105
Circulatory Disorders with Heart Attack
Without Complications
Discharged Alive

NUMBER OF DRGS ACCOUNTING FOR PERCENTAGES OF MEDICARE INPATIENT EXPENDITURES



(Based on 1979 Medpar Data)

Chairman Rostenkowski. Thank you, Mr. Secretary. I understand you are under some time constraints and that you will be able to answer only a few questions and Dr. Rubin will be able to answer only a few questions, and that Commissioner Svahn will be available for the social security inquiries.

Mr. Secretary, does it matter if the doctor who orders the hospital care is not involved in the prospective payment of the plan and thus has no direct incentive for efficiency in providing care? Is it possible that he is not involved and that he won't be as much concerned about cost-related items?

Secretary Schweiker. You mean services outside the hospital or inside the hospital?

Chairman Rostenkowski. Well, he ordered the hospital——

Secretary Schweiker. Oh, yes. That frankly is one of our problems right now. We have three parties ordering or structuring the service. We have already seen signs of this in New Jersey. This new tool gives a hospital administrator an opening point to go back to the people who order the service, who deliver a service and say, "Look, if another group can do this for $3,000, why do you folks end up with a $6,000 bill?" And if you can show them that there is a quality factor here that they are not getting, fine. But it gives the manager of the hospital a new tool to go to the doctor and have discussions with him about why his procedure is different.

In fact, we have already had a case in New Jersey where one was double the charge by the next hospital, and the administrator went to the doctor and the doctor just could not show any difference and they immediately changed the procedures.

So I think it gives the administrator a talking point to deal with a doctor and it gives a doctor an objective measurement of what his performance is.

Chairman Rostenkowski. Mr. Secretary, this is a major change in reimbursment methods. Do you think it has been sufficiently tested?

Secretary Schweiker. First of all, the statistical base has been well thought out. We have sampled one out of every five medicare cases that have come through the system, as part of our MEDPAR project, so we have a 20-percent sample of what is involved. That is a pretty significant basis for a national sample.

In addition, before MEDPAR we made a basis for making these judgment calls. I think that empirical base originated at Yale. And we have observed the operation of the New Jersey system.

I don't want to pretend that when you implement a system of this size, there won't be some problems. On the other hand, we believe that the problems can be worked out and we think we have to be understanding in our procedures and processes to realize that there is a transition factor involved.

So I guess my answer is that we believe realistically that New Jersey has demonstrated the system to be feasible and practical. Our system is not as complex as the New Jersey one, I might add. I think it is important to say that New Jersey went a very important step beyond us so that we can understand the difference. New Jersey has a DRG system. They also have a total hospital budgeting system whereby they review the budget, per se, for each hospital. If we put the exact kind of system as New Jersey's in place, then the answer to your question is, no, we couldn't handle it because we are not attempting to run the budgets of 7,000 hospitals in this country. But we are taking what we feel is the best part of the New Jersey system, and the one that is easiest to administer, and the one that we believe has a track record and proposing to apply that system on a national basis.

So because we are not trying to administer the budgets of hospitals, we believe it can be done, given some logic and rationale and reason as to how we integrate the systems.

Chairman ROSTENKOWSKI. Mr. Conable?

Mr. CONABLE. Thank you.

Mr. Secretary, I am sorry I was not here when you began. I think your appearance here on the last day at the Department is symbolic of your leadership and I am glad you have been able to explain the health care system here before us today.

I am sure that my colleagues will try to find ways to improve on the proposal as it works through the legislative process, but it will be the centerpiece of our deliberations on hospital reimbursement because of the work you have put into it and because it does appear to be a hospital plan.

You were referring to New Jersey, in particular, and I do understand that in order to avoid major disruptions in hospital finances the system was phased in over several years there and I am wondering if you think this system should be phased in if we were to adopt it here currently and if so, how could it be done without reducing the savings projected from the limits on hospital reimbursement included in TEFRA last year? Have you thought about that at all?

Secretary SCHWEIKER. Well, you are right, Congressman Conable, about the phasing. I think one of the reasons that New Jersey needed a phasein, and I want to come back to this point, is that they have a dual system, a DRG system and a prospective budgeting system for each hospital. So they have to regulate, pass on and approve the budget of each hospital. With 7,000 hospitals we would have been dead in the water if we tried that. I think that was the most important reason the system needed to be phased in.

So I don't think it is totally similar. By the same token, I would envision, Congressman Conable, a year here that we allow for a dual-track operation whereby all the new systems blended together.

Mr. CONABLE. Well, I notice that you are saying some hospitals would not be included at all because of their special character or location and so I understand that you would have a dual system, you say?

Secretary SCHWEIKER. Well, what I would look for is something like that.

TEFRA is really a step toward this system and that is what I think is important, because we do begin to see, under TEFRA, an index that applies to a hospital's case mix.

So we can pick up what you folks have given us in TEFRA in regard to case mix and pretty well translate that right into a DRG system.

We believe that we should set up in such a way that people would have the better part of a year to merge the TEFRA system with this system. By the same token, we also think that we are going to find it easier than if we simply started with the old system without paving the way with TEFRA because under TEFRA payment is on a per case basis and a case mix formula is used.

I think we should have some way of transiting, but I also believe it can be done in a reasonable length of time and should not be dragged on.

I would hate to see a dual system go on for years because you will double the paperwork and double the bureaucracy.

Mr. CONABLE. And, obviously, we would not meet the savings goals that we have set.

Secretary SCHWEIKER. That is right.

Mr. CONABLE. Well, thank you very much, sir. We wish you well in your next incarnation. I appreciate the fine relations you have had with this committee and all the work you put into this proposal.

Secretary SCHWEIKER. Thank you, sir.

Mr. CONABLE. That is all, Mr. Chairman.

Chairman ROSTENKOWSKI. Mr. Pickle?

Mr. PICKLE. Mr. Chairman, I am sorry I was not here in time to hear all the Secretary's testimony with respect to the social security change, but I understand you endorse the package and want to keep it together. I have a specific question in that area for Secretary Svahn, so I won't go into that area except to say that I welcome you here and we will need the active help of all of your Department and Secretary Svahn to help pass this bill and keep it together. I am glad we are working together and I appreciate the support you have given.

Mr. CONABLE. If the gentleman will yield, we need the help of the insurance industry, too.

Secretary SCHWEIKER. Well, I thank Congressman Pickle. I want to say he has been a real stalwart supporter of the need to solve the problem and we intend to give him the same kind of support in our Department because he has been helpful to us.

Mr. PICKLE. Thank you, sir.

Chairman ROSTENKOWSKI. Mr. Rangel?

Mr. RANGEL. Thank you, Mr. Chairman, and Mr. Secretary. I want to thank you for your tenure as Secretary as the administration has attempted to embark on many untested theories. I have always felt some confidence that with you there, we have had complete access to you. You have shown a sensitive understanding for some of the hard times that we were facing, even to the point of kidney patients in need of dialysis. You have managed to become personally involved in the lives of just a few people who were adversely affected.

Now, we start on a relatively new theory that certainly has merit. I can see a lot of thought has gone into exempting hospitals that have unique problems. One problem that I seem to be always raising is that of hospitals that are located in our poorer communities. What bothers me is that no one disputes the fact that these hospitals serve sometimes as the only source of health care for poor families. They act as a magnet for those people without coverage. They attract illegal aliens. Even our spiritual hospitals have no problems now with transferring patients to the public hospital systems and the nonspiritual ones just dump them. Ambulances don't even take patients to the private hospitals.

If the whole idea is to be competitive by trying to keep cost down and being held hostage to the profit and loss statement, it just seems to me that this will be an open invitation to unload patients on those hospitals that don't have the right to close their doors to people in need of health service.

I just was wondering during this transition whether any thought was given to exempting public hospitals that are located in low-income communities where the average patient comes in with multiple diagnoses for a variety of illnesses that are just not going to show up on a computer. It is not going to work and if this system is as good as you think it is, it is going to force good hospitals to unload those type of patients on the public hospital system.

I want so badly to support your program. Have you given any thought to what the public hospital system would be up against if this is enacted?

Secretary **Schweiker**. Thank you, Congressman Rangel. One of the reasons I selected this system over some of the other prospective proposals is because I think to some extent it is biased toward helping sicker people and people that have unusual problems. Let me recapitulate. This system applies only to medicare. We pay all bad debts in medicare. So if you are talking about inner-city areas with bad debts under medicare, we pay 100 percent of those bad debts. We get into some other arguments outside medicare, but this system is only proposed for medicare.

No. 2, we do have a system that pays more for sick people. To some extent, you may see another factor at work here. You may see a system work whereby some of the hospitals who have been ducking the sicker patients may decide it is more profitable to take sicker patients because they are going to get paid less for their well patients. We are going to pay more money for sicker people. The more complications they have, the sicker they are, the more money a hospital receives for their care.

No. 3, we are going to have an "outlier" policy which says that wherever you have an unusual case—one that runs 3, 4, 5, or 6 months, we will pay for that outlier situation. I think that is important.

No. 4, we are going to pay a wage factor. The inner city hospital usually has higher wages. They are going to get paid higher wages.

No. 5, an inner city hospital is usually a teaching hospital. We are not putting teaching hospitals under the DRG in terms of their direct teaching costs and indirect teaching costs.

Mr. **Rangel**. Let me ask in the teaching hospital situation you know we have this municipal fleet of hospitals. Do you exempt the entire corporation if there are 16 or 17 public hospitals underneath it or just those hospitals that are affiliated with a teaching university?

Secretary **Schweiker**. Well, any hospital that has a teaching function will have direct teaching costs and indirect teaching costs passed through. But it is just the teaching costs of the hospital.

Mr. **Rangel**. You will be missed, Mr. Secretary.

Chairman **Rostenkowski**. Mr. Gradison.

Mr. **Gradison**. Thank you, Mr. Secretary.

I, too, want to thank you for your assistance in your present position. You are really going to be missed.

With regard to this proposal, of which I think very highly, I am aware that there have been criticisms of it from some hospitals which would prefer a system which is based upon institution specific DRG's rather than the nationwide approach adjusted for local wage levels.

I have been concerned that the institution specific approach might substantially reduce the incentive to reduce costs which is a fundamental objective of this. But it is on the table now and I believe it has been endorsed by the American Hospital Association and I would appreciate it if you would share with us your thinking on that issue, that choice.

Secretary **Schweiker**. Well, the American Hospital Association, I might say has been very constructive and cooperative with us, has been looking at two proposals. This is one of them that you mentioned, Congressman Gradison.

I would have to say I would have great concern about going this route because all this does, as we see it, is freeze in the old system. Because as soon as you get a DRG system that is hospital specific, you relate strictly to an inefficient hospital and keep this profile going; you keep the profile of another hospital that is efficient going, and you freeze in all the negative features of the old system.

Now, AHA has also said they are willing to look at another proposal and that has a regional breakdown. We are frankly willing to look at a regional breakdown.

Our preliminary data indicate that there is more difference within a State than a region, but we are studying that right now. We might consider a five or six regional rate structure as a possibility. So we are willing to look in the direction of the region if there is really a difference. There may or may not be. Our statistics, I think, will show one way or the other. We think that would be a constructive proposal, but really, to go to a hospital-specific diagnosis base just freezes the old system and puts a new system in place that would have all the old faults. That is why we honestly can't support it.

Mr. **Gradison**. Mr. Secretary, how long will it take to have that data? I understand the Health Subcommittee may be moving on this rather soon.

Secretary **Schweiker**. I am trying to get something done within a week. I hope we will have something within a week for you.

Mr. **Gradison**. Mr. Secretary, with regard to social security and the medicare problem, there is one obvious connection and that has to do with the fact that the HI Fund has lent something over $12 billion, I believe, in order to keep the checks going out on time.

In a sense, what has happened with regard to the old age benefits is we are reaching a point at which the payments would not be made in a timely manner because of the inadequacy of the trust funds.

I am concerned about the possibility that the same crossing of the lines, that same inability to make timely payments might happen with regard to medicare. And, in particular, about the possibility that the date when the lines cross will be hastened unless that $12 billion, or whatever it turns out to be, unless that is repaid very, very promptly, I mean in the next couple of years. I wonder if you can give us any inkling as to what we might expect.

In frankness, having seen the problems we have had with social security, I don't look forward with any relish to the thought that we might think we have solved that problem and be back here facing the same constituency, the elderly, with regard to their health insurance benefits and the same basic issue of how to resolve the problem through higher taxes or benefit adjustments.

So, I personally feel that to the extent we can, we ought to be looking at both of these issues at the same time and in particular making sure that those advances are paid back promptly.

Can you shed any light on this?

Secretary SCHWEIKER. Let me say, Congressman, I share your concern. We have lent the hospital insurance trust fund $12.4 billion. Now, as a trustee of that fund, the understanding among all the trustees is that that money is to be paid back, so we very much need the one thing that your committee is trying to get out, which is to settle the overall social security problem. Because, obviously, if there is a settlement of that problem, then we will be able to reimburse, which we owe, the hospital insurance trust fund and I guess that gives us even more reason to argue the urgency of settling the social security problem so that we can reimburse and put money back in the fund.

But I think your point is exceedingly well taken. It is all linked together and if we can't solve one, it is like a row of dominoes, the other is going to fall, too, and we, as trustees, are very cognizant of the fact that a settlement is needed, not just to help social security, but to stop the hospital insurance trust fund from having lost $12.4 billion from borrowing, from being depleted. So there is a time urgency and I am glad the chairman recognizes that by conducting these hearings right now.

Mr. GRADISON. Mr. Chairman, one related question, if I might. Would you support an amendment to the social security package that would require payment of these advances back to the HI fund within, let's say, 2 years?

Secretary SCHWEIKER. Sure, I certainly would because I think that is my understanding of what we should do.

Mr. GRADISON. Thank you very much, Mr. Chairman.

Mr. PICKLE. I heard you, too, Mr. Gradison.

Chairman ROSTENKOWSKI. Mr. Jacobs.

Mr. JACOBS. Mr. Secretary, first, I echo the compliments that have been given to you thus far in these hearings. In plain English, I believe you are a good guy and we thank you for the service you have given your country in this job. Also, I believe the administration has come up with a very useful proposal and perspective payment for hospital costs under the medicare program.

As I see it, your department generally is a perspective payment department. This is the one exception where you might say cost plus has been employed.

I have always suspected that this cost-plus problem over at the Pentagon is probably what turned "Cap the knife" into "Cap the bayonet spendthrift," or B.S.

On this question of reimbursement, within 2 years of the medicare trust fund, I am somewhat troubled by your own assertion, Mr. Svahn, I believe, that even with the proposed so-called package legislation for old age and survivors, the medicare trust fund could not be paid until the end of the decade.

So, I find some conflict in the information that we have received on that.

Secretary SCHWEIKER. Well, I thought that Congressman Gradison was basically saying that he wanted to make some changes to allow it to be paid back. My intended answer was to indicate that we do have to replenish the hospital fund as part of this operation or we won't be able to pay benefits there.

So when it is done one way or the other way, I guess I would say, yes, sir, we do have to do it. Part of it, I guess, is a technical way to proceed. But we certainly need to do it if we are going to have money to pay out of the hospital trust fund.

Now, how we do it, mechanically, obviously this committee has a great deal to say on that.

Mr. JACOBS. It has got to be done with money and as I understand it, there would not be enough money in the old age and survivor's trust fund to repay the medicare trust fund even with the new legislation until the end of the decade and, as I also understand, our trust fund for medicare is supposed to be out of money before that time and I see a gap there that troubles me.

Secretary SCHWEIKER. I am not quite sure what the question is that you are specifically asking me other than to point out there is a major problem here which I concur with.

Mr. JACOBS. If we pass the package, as I understand it, even with the package, there will be insufficient funds to repay the medicare trust fund until the year 1990. Mr. Gradison has suggested legislation requiring that it be repaid within 2 years and there is a disparity there.

Secretary SCHWEIKER. Well, I think we are talking about a phasing question here and maybe that is where we are not quite on the same wave length.

I think the payment process should begin immediately so that we can pay funds out of it. Whether it is totally and completely paid by the end is probably the question here and I guess our urgency is paying enough into the fund to be able to handle the fund.

It is not quite as critical that we get a surplus in the fund beyond what we need, so we can phase in the final payment as long as we get enough operating funds in to do the job.

Mr. JACOBS. Does the medicare tax have to be raised in this decade? Does the administration believe that the medicare tax has to be raised along with the old age and survivor's tax?

Secretary SCHWEIKER. Let me say we have one other function at work here. I did appoint in accordance to law an association security commission in addition to the President's and Congress Commission on Social Security because they were already meeting on the issue. The new commission is going to address primarily the medicare problem.

Mr. JACOBS. Thank you very much for everything.

Chairman ROSTENKOWSKI. Mr. Guarini.

Mr. GUARINI. Mr. Secretary, I also want to thank you for the great help that you have given to this committee and the great service you have performed for our Nation on the whole.

Coming from New Jersey, I was very interested in the remarks made about DRG and the budget system. We know that New Jersey has really done a very good job in regard to containment of hospital costs.

Pilot projects have worked pretty well there and we are very proud of the track record that we have in New Jersey.

I see something else that is coming up very quickly. It is what we call mini hospitals where the operation is performed, there are no rooms for people to stay over and they are in and out the same day.

How would DRG be affected by this kind of a mini hospital, no frills kind of an operation?

Secretary SCHWEIKER. They would be paid on a cost basis under our present plan.

Mr. GUARINI. Would there be a windfall to them because they do not have to have all the supporting services and the hospital beds and the necessary expenses that would go with it? I wonder whether or not there should be some kind of provision for them as you made other adjustments.

Secretary SCHWEIKER. Let me say, Congressman, that the difference that we make here, and it is somewhat of an artificial difference is that this is an outpatient payment and we aren't attempting in this package to come up with a prospective payment for doctors.

I think it is important, though, that we will be able to take a look at expanding the system in the future, much like capital costs, but we don't propose to do anything about it now because we feel if we undertake too much and make it too broad it will just be too difficult to administer.

Mr. GUARINI. I think that is a fair comment. I wonder whether or not that is a trend that is happening throughout the country where hospitals are not keeping people very long or not keeping them at all, if possible.

Secretary SCHWEIKER. Well, we do see a trend for ambulatory surgery throughout the country because it is usually more cost effective and because of the fact these facilities can lower their overhead costs by making combinations.

So I guess the answer is yes, and we encourage it, and we certainly want to make sure that the new system does nothing that discourages that trend or somehow sets it back.

Mr. GUARINI. It will keep the prices down?

Secretary SCHWEIKER. Yes.

Mr. GUARINI. Thank you.

Chairman ROSTENKOWSKI. Mr. Moore?

Mr. MOORE. Mr. Chairman, I first want to compliment you and Mr. Jacobs, the Chairman of the Subcommittee on Health, for your willingness to seriously consider this proposal of prospective reimbursement.

Mr. Secretary, you served in the House of Representatives and U.S. Senate and the past 2 years as Secretary of HHS. I, for one, think that is a very distinguished record of public service, one you should be congratulated on and thanked for.

Since this is indeed your very last day on the job and you are spending a portion of that day before the Ways and Means Committee advocating something as dynamic, as new, and as promising as this approach, I think it is indeed a fitting end to a very distinguished public career.

Without prospective reimbursement I think we are facing some very unappealing choices on what to do about the spiraling cost of medicare and medical costs in general and the fact that you are bringing us something that offers us a very promising way out of this morass is to me something for which you should be thanked.

This may well go down as something you have fostered in the past 2 years and one of the very high points of your career.

Mr. Secretary, I am concerned, as Mr. Gradison was in his comments, about the future imbalance of funds in the hospital trust fund. Separate and apart from the borrowings now to support social security, I understand that we are going to be running out of money in that trust fund. It is a situation where we are not going to be able to pay medicare checks.

Could you tell us when, by your best estimates, separate and apart from the borrowings for social security, we are going to run into problems with that trust fund?

Secretary SCHWEIKER. Without borrowing more.

Mr. MOORE. Without considering the borrowing situation. I understand that aggravates it tremendously. Separate and apart from the borrowing when will we be running out?

Secretary SCHWEIKER. Assuming that the money that is borrowed now has been put back, is that what you are saying, our best guesstimate right now would be the end of the decade if the money that we get is put back.

Mr. MOORE. You are saying by 1990, 7 years away, we are going to be in a position where we can't pay medicare bills on time even if we have the social security borrowings repaid?

Secretary SCHWEIKER. Well, let me say that that is probably the outside year. If our economic assumptions and economic indicators tend to be more pessimistic than they are then it could happen sooner.

I think there is one point to make here. You raise a good point. The social security problem developed gradually over 7 or 8 years. We all sort of had plenty of warning on it. A little bit of it happened each year. The profile on the hospital insurance trust fund is totally different and that is, all of a sudden it sort of drops over the edge of a precipice because of the increase in inflation, because of the population's demographic changes and because of the way the costs are escalating.

So, while we do know now that it may be 4 or 5 years off we will have a situation where we think we are great and then all of a sudden it goes overboard.

So it is really important to deal with it now because if our economic assumptions are wrong as they obviously were when the 1977 social security update was passed, it could happen sooner than 1990.

Mr. MOORE. Mr. Secretary, in a way, then, this problem we are facing just 5 or 6 or 7 years away is every bit as serious as what we are facing right now with the social security retirement fund?

Secretary SCHWEIKER. It certainly is and I think it is very important that this committee recognizes that.

Mr. Moore. Mr. Secretary, in a statement that you made when you released your report to Congress on prospective reimbursement, you indicated that prospective reimbursement could conceivably be in effect at the beginning of the next fiscal year, October 1, 1983.

My question to you is, if we are facing the kind of problems we are facing, prospective reimbursement will help make, in your words, medicare a more prudent buyer of medical services.

Therefore, it would seem to me this would be reducing the spiraling cost or drain on the medicare system. So, should we move as quickly as possible to implement prospective reimbursement?

Secretary Schweiker. Well, we certainly support that answer which is, yes. What I guess we are saying is that if this committee acts promptly and puts something into place beginning, say, for October 1st of this year, we still feel, even though we would begin to think October 1 as I think Congressman Conable or someone else asked me, you are going to need the better part of a year you are operating in to give a transition year for people.

So, you are right, the sooner we act the better and the sooner we can see some results.

Mr. Moore. And you would like to see this done by October 1, 1983?

Secretary Schweiker. I would like to see the legislation passed early in this session so that we can become operative in terms of putting the hospitals on notice in a reasonable period of time, as soon as this committee feels it is feasible. The sooner the better.

Mr. Moore. Thank you, Mr. Secretary.

Mr. Pickle [presiding]. The Chair recognizes Mr. Pease.

Mr. Pease. Thank you, Mr. Chairman.

Mr. Secretary, I, too, wish you well and I ask just one question. I presume that under this plan hospitals would be paid by the type of illness without regard to the amount of time spent in the hospital by a patient; is that correct?

Secretary Schweiker. That is correct, except for the outlier case that I mentioned, yes.

Mr. Pease. So, in terms, then, of the ordinary illness, have you considered whether this builds in an incentive for the hospital and the doctors at the hospital to discharge patients a day or so earlier than might be prudent for medical reasons?

Secretary Schweiker. Well, yes, we certainly looked at that, Congressman. It is a very valid point. You either have to pay a per case basis on the basis of admission or on the basis of discharge. We felt if you paid on the basis of when you are admitted that there will be a real incentive to admit a lot of people.

We feel we would rather have a little bit of a mixed incentive; that is, length of stay is a factor to consider if payment is on a per-discharge basis.

To address your question regarding hospitals having an incentive to discharge prematurely, we believe there are two considerations. First the patient themselves obviously can complain or say they are not ready to go home, and there is also the malpractice situation. We believe that one of the real silent enforcers of this system is going to be malpractice. Everybody pays high insurance for that. The doctors are quite sensitive to it and we figure that if people try to manipulate the system they subject themselves to malpractice suits. So that to some extent will be a mitigating factor. We will keep a record, though—and we now have records of each hospital's case discharge load—and if we see an unusual trend we can go back and put a finger on a hospital that is doing that after we get a complaint or two.

Mr. PEASE. Thank you very much.

Mr. PICKLE. Mr. Dorgan?

Mr. DORGAN. Thank you, Mr. Chairman.

Mr. Secretary, I am very interested in the proposal that you addressed today and I think it has a great deal of merit and I commend you for it.

I would like to ask you a more general question, if I might.

What was the increase in hospital costs in the past fiscal year? I know it was at least double digit.

Secretary SCHWEIKER. 12.5 percent, while inflation was 3.9 percent. It was triple the rate of our present inflation.

Mr. DORGAN. In your opinion, why is it that large, given the rate of inflation?

Secretary SCHWEIKER. I think two basic reasons. No. 1, that I alluded to earlier, is that the patient directly doesn't pay the bill so nobody cares. It is sort of a cost-plus system. Everybody just sends the bill along and ultimately one of two people pay the bill.

I pay the bill, 40 percent of all hospital bills in this country or industry pays the bill through a group insurance plan. It is so far down the road that nobody cares and they all buy the highest service and pass it on.

The second reason is I think that in a third-party payment system the patient really doesn't know the bill, doesn't see the bill, doesn't understand it and has no critique of the system that it is being charged by.

Mr. DORGAN. I have read some articles recently and you have probably read them, too, that suggest that perhaps the rather dramatic decrease in the rate of increase in hospital costs that occurred a few years ago is because of the threat of cost containment legislation being pushed by the Carter administration and the potential of it being accepted by Congress. This forced the hospital associations and the hospitals to be very aggressive in seeking their own cost containment approaches. In the absence of any kind of pressure like that, save for proposals like this coming from this administration, has sort of taken the pressure on. What is your response to that?

Secretary SCHWEIKER. Well, there is no question that the hospital costs slowed down when there was an issue of whether there was going to be a hospital cap, no question about it. And if that trend could have continued, maybe we could have solved the problem. But once the pressure dissipated for whatever reasons where the situation reversed itself, costs began to speed upward again.

So we just are not able to do it that way. And while it might have had a short-term impact, the long-term outlook has been unfortunately, very bleak.

Mr. **Dorgan**. But does that mean that when we see costs triple the rate of inflation, there might well be some pressure from an adminstration or from Congress for cost containment?

Secretary **Schweiker**. I think if we don't go into a system like we are proposing now, and this is the point I made to the hospitals themselves, you are going to get a regulatory cap system. You are going to get a government stereotype straitjacket. The nice part about this system is it is half regulatory and half free market. By setting a price but saying you run it, you make a profit and you operate it, it is half free market. We think it is the best of both systems.

Mr. **Dorgan**. I come from a part of the country that has virtually no competition in hospitals. Maybe in a couple of major cities, but by and large they feel fortunate to have a hospital to go to. We do indeed have dramatic increases in hospital costs in the rural parts of the country. I understand your exemption and I support it. I would be very concerned about this if it did not have an exemption for the rural areas. But even with that exemption, how do we in rural areas get a handle on tremendous increases in hospital costs?

Secretary **Schweiker**. I think one of the things that this will do is it will begin to set national standards on what pricing is expected, given certain labor rates, and even though we will grant exemptions, we will have a tool, as the managers will have a tool, to go back and say, hey, wait a minute, sure you are a sole provider, but do you really need to charge twice what the hospital down the street does. I think we can give a management tool through a pricing comparison that they don't have now, so there will be a lot of indirect pressure and still protect the quality and access to care.

Mr. **Dorgan**. The rural exemption is the exemption in areas where there is not competition. How is competition defined?

Secretary **Schweiker**. Presently we define a sole community provider as the only one in a 25-mile area. But there are some other provisions that give us the prerogative to go beyond that, where these are extenuating circumstances—weather conditions for example, and we will look at othe[illegible]ors as well. Other criteria would evolve from regulation.

Mr. **Dorgan**. Thank yo[illegible]

Chairman **Rostenkows**[illegible] As [illegible]ed out, I know you are under some time constraints and th[illegible] have to leave. I know that Dr. Rubin will stay here and [illegible] questions with respect to cost reimbursements and C[illegible]er Svahn will be here to answer any questions [illegible] social [illegible]ecurity, so I would like to say there is always mixed [illegible]motions when somebody leaves public service.

I had the great privilege of serving with you in the House of Representatives when you were here and certainly, Dick, you were an asset not only to the country, but to your party as well, and I am certain that this administration will sorely miss your service. I know that in your service as Secretary there have been very pleasant moments and certainly in the confines of your office, very educational moments about just what HEW is all about.

So on a personal basis, I want to express my gratitude, but one has to understand when you are raising a family, there are certain obligations that have to be met. It is a shame we can't pay salaries that are commensurate with a decent family style.

Secretary **Schweiker**. Thank you, Mr. Chairman. It has been a privilege to work with your committee and a pleasure, too.

Mr. **Ford**. Mr. Chairman, I know that the Secretary included in his printed statement for the record of the committee a statement about the SSI changes. I know you have to leave, Mr. Secretary, but if you will take 30 seconds to respond for the record on the SSI changes as they relate to the budget proposal as well as the changes that were recommended by the Commission. You do address the problem here in your written testimony.

Chairman **Rostenkowski**. Dr. Rubin is going to stay on to answer for the administration. The Secretary is terminating as of 5 o'clock this afternoon his term of service in the Federal Government. It is up to the Secretary.

Thank you, Mr. Secretary.

Mr. Thomas?

Mr. **Thomas**. Thank you, Mr. Chairman. The Secretary said that the sicker they are, the more we will pay. It is probably going to lead to a more thorough diagnosis of patients which on the one hand is good, but what checks are there on overdiagnosis and what kind of ability in review procedure do you have on the diagnosis in terms of classification in those over 400 categories?

Mr. **Rubin**. We would have an audit procedure that is currently in place by the Health Care Financing Administration. The audit would be of two types, both the fiscal audit as well as medical audit to insure that the so-called DRG creep that you are talking about would not occur.

Mr. **Thomas**. The mechanics of the audit would be that you would review individual hospitals or it is tied to doctors in the hospitals? What is it tied to in terms of review?

Mr. **Rubin**. The audit procedure would be done by the intermediary who would tie it to the actual discharge documents that would be sent to the intermediary in order to get payment.

Mr. **Thomas**. Thank you, Mr. Chairman.

Mrs. **Kennelly**. Just to follow up on that question. We talked about region and we talked about inefficient hospitals. Is there any thought about categorizing hospitals according to sizes and kind of diagnoses?

Mr. **Rubin**. Indirectly, we are doing some of that by paying the full cost of teaching, both direct and indirect costs. In general, teaching hospitals tend to be our larger hospitals, so-called terciary care hospitals rather than the primary care, small hospitals that you have described in your question.

The other point I make is that one of the things that we would hope to have occur under this program would be that hospitals, as the Secretary outlined in his statement, would begin to specialize.

That is to say one hospital may be more efficient in providing coronary artery surgery, but not terribly efficient in doing cancer radio therapy. Whereas another hospital may not be very efficient in doing cancer radio therapy, but very efficient in doing coronary artery surgery. One would expect that the first hospital would increase the number of patients that it has requiring coronary artery surgery. The second hospital would increase the cancer radio therapy patients.

So they would be able to produce better quality care at a lower marginal cost.

Mrs. **Kennelly**. Thank you, Doctor.

Chairman **Rostenkowski**. Mr. Duncan?

Mr. **Duncan**. Thank you, Mr. Chairman.

Under existing law, dispute over medicare payment to hospitals is subject to judicial review and I might say that the committees pretty well through the years favor judicial reviews as a matter of fairness. But certainly it has been expressed as the administration now proposing to eliminate judicial review under its prospective reimbursement system. Would one of you care to clarify for the committee the change being proposed with respect to judicial review if there is any?

Mr. **Rubin**. The only part of our proposal that we would exempt from judicial review is the payment rates. If there were clearly administrative mistakes in what a hospital reported and what we paid a hospital, all of the capital medical education passing through, outpatient costs, et cetera, those would be fully subject to a judicial review. The only thing that would not would be the payment rates themselves.

Mr. **Duncan**. Thank you.

Chairman **Rostenkowski**. Are there any further questions of the witnesses with regard to social security costs reimbursement?

[No response.]

Chairman **Rostenkowski**. Commissioner, are you going to have a statement? I was under the impression that the Secretary made the statement for both, but if you have a statement, we will be glad to take it?

Mr. **Svahn**. No, he certainly did. I was prepared to read what basically is his statement, but it is 21 pages long and I would be pleased just to let his statement stand for the record.

Chairman **Rostenkowski**. If you would like to summarize the statement?

Mr. **Svahn**. I think I would just like to say one thing, Mr. Chairman.

It is a pleasure to be here today before this committee, a committee which has worked so hard to solve the social security problem. If I had to summarize what our administration believes about the bipartisan proposal for resolving this problem that we face in social security, it would simply be that while what the Commission has proposed may well not be the best of all possible worlds from all of the points of view that have focused on the problem, the Commission's proposal is clearly, I think, the best solution that we can expect given this real world that we live in.

We have seen over the past 2 years an awful lot of talk about the problem. We have broad bipartisan support and I am very much in favor of the bipartisan Commission proposal passing.

Mr. CONABLE. Mr. Chairman, I understand that the Secretary was under some pressure and I do have some questions of the Commissioner.

Chairman ROSTENKOWSKI. Mr. Conable?

Mr. CONABLE. I think the members of the committee may also want to consider specifically the administrative aspects of social security in connection with the bipartisan proposals before us.

For instance, somebody on NBC a couple of nights ago raised the issue of whether the Commission's recommendation to tax benefits resulted in a new marriage penalty. The issue was the $25,000 threshold. If you had an elderly couple, they could divorce. There are all kinds of subterfuges for getting under the $25,000 threshold.

Then you get a $40,000 threshold, assuming that you are willing to divorce for that purpose. I am wondering if you think the thresholds ought to be revised to more nearly equalize the tax treatment of individuals and couples.

As one of the negotiators, I can tell you there is nothing very artistic that went into estabishment of those thresholds. It was a negotiated compromise. In effect, as most things are, it is difficult to justify in a vacuum. As far as I am concerned, doing anything that would be dissruptive to the agreement which underlies the so-called consensus—would be a problem. I just wonder if you would comment on it.

Mr. SVAHN. Well, Mr. Conable, you were obviously in many more of the meetings of the Commission than I. I think the members of this committee have dealt much more with the issue of a marriage penalty in the tax laws and the Treasury Department has done the same for the executive branch of Government.

I think that if we start, and I know that most members of this committee have heard this before, but if we start to look at each individual piece of that bipartisan compromise, there is not a single piece in there that all of us would agree on except as part of a package to solve social security financing problems.

Mr. CONABLE. I agree with that.

Mr. SVAHN. If we start to say, I would like to fix this little piece this way, I think this very fragile document—and Mr. Conable knows how much effort went into negotiating the document—if we start to pick piece by piece at it, the entire document will come apart because I am sure that every member of the committee has a piece of that document he or she would like to see taken out or modified or changed.

Mr. CONABLE. Well, let me ask you a more sensible question then from an administration viewpoint. That is, what is in that compromise that gives you concern in terms of the additional burdens it places on the Social Security Administration. Your problems over there are well known, the fact that you have outmoded computers, the fact that Congress has imposed additional burdens on you through SSI and black lung and other legislative changes that have not been met with additional personnel, the fact that you are under the Department of HHS and, therefore, have passed onto you requirements to cut back on personnel. At the same time, your futures are proliferating and your total system continues to grow almost geometrically.

In short, we are well aware that you have some very severe administrative burdens and I wonder what in this package gives you concern that the mushroom cloud hanging over Baltimore will not betoken an atomic attack, but final explosion of the whole administrative structure of social security?

Mr. Svahn. Let me just say, Mr. Conable, there are a number of problems that we have identified in the Commission's package which are going to cause administrative problems for the Social Security Administration. The package, as you well know, is fairly new. We are looking at it. The details have not been worked out with the committee and with the Congress and we will be working on ways to mitigate the administrative problems as the legislation is drawn up.

Just for an example, let's take the taxation of benefits for individuals with adjusted gross incomes of over $20,000 and for couples, adjusted gross incomes of over $25,000. We don't keep records on the amount of social security benefits that are annually sent.

Mr. Conable. Well, frankly, that is one of the reasons that we went the taxation of benefits route rather than reducing benefits in the high income brackets, because we knew you did not have the capability of adminstering a needs test to people for outside income. While under the form 1040, it could be easily handled, do you see any administrative problems, however, in the estimation of the amount of money that will have to be transferred from the General Treasury to the social security system as a result of the taxation of benefits or is that going to be purely a Treasury problem and not anything that affects you?

Mr. Svahn. Well, it is a joint problem because, in our earlier discussions with them, Treasury has said they will want 1099's from social security saying that we sent this much money to each one of these beneficiaries. Right now I have to say that we cannot do that. Assuming that this part of the package passed, in the initial stages we would rely on the same mechanism that the Internal Revenue Service has relied on for years in collecting tax from people who have certain types of income; and that is the honesty of the taxpayers in reporting all their taxable income accurately.

I think that assuming a rapid passage and early enactment, that it is something that we will have to do.

Mr. Conable. One can envision, actually, the possibility that as time goes on and the threshold comes down in real terms, the possibility of our having to put in some form of withholding.

Mr. Svahn. That is another step we are not able to take.

Mr. Conable. Well, obviously, we are going to have to work with you on that and I know you will be thinking about administrative problems.

Mr. Svahn. We are, Mr. Conable.

Mr. Pickle. Thank you, Mr. Chairman.

In connection with Mr. Conable's line of questioning, I know that we are in the process of modernizing our equipment. The present budget, does the present budget submitted by the administration offer any problems to you that are serious that you don't think you can overcome? Will we still be on schedule on the modernization plans we have?

Mr. SVAHN. The 1984 President's budget includes all the funds that we need to stay on schedule with our systems modernization plan. I might also add, Mr. Pickle, that we are ahead of schedule on redesigning our data processing system. I am quite pleased with the progress we are making. We are in the stage now where we are going to start to make some real progress.

Mr. PICKLE. I am afraid to ask you how much you are ahead of schedule, but you are at least not behind. That is encouraging.

Mr. Secretary, the National Commission report indicates that there might be a possibility of some softness in our figures in the immediate years ahead in this decade. They list several approaches for a fail-safe mechanism. Does the Administration have any preference to the type of fail-safe mechanism we would follow in the immediate years ahead?

Mr. SVAHN. Well, Mr. Pickle, I am not sure how much we need a fail-safe system and I would apologize to the chairman, and you as the chairman of the Social Security Subcommittee for the fact that we were not able to get the economic assumptions for the 1983 trustees report done before this hearing. I hate to blame it on the systems problem, but we did have one. We should have that information for you by next week.

Mr. PICKLE. You are saying that as far as recommendations or a preference, you would have that in our hand within a week's time?

Mr. SVAHN. What I was indicating was that within the week we will have the new assumptions agreed to by all the trustees and we will have some projections as to trust fund balances for you.

Mr. PICKLE. Well, again, to get back to my point, I want to know, does the Administration have any preference for a fail-safe approach in the event we have to provide for it?

Mr. SVAHN. At the present time, we don't. We have looked at the different options the Commission looked at.

Mr. PICKLE. Well, if you have a preference, I would ask you to submit them immediately or forever after hold thy peace.

Let me ask you in connection with the long term, do you have any preferred solution on the remaining long-term deficit?

Mr. SVAHN. I don't have a preferred solution. As I said, the Administration supports the package. As you know, the package has two alternative mechanisms for shoring up the .58 percent of payroll deficit that was not specifically addressed. The majority of those who signed off on the package recommended going one way and that was to gradually, over time, increase the age of retirement to 66. The minority of those signed off in a different way. I think that that is part of the debate that has to go on here in the Congress as to how we are going to do that.

I do not have an Administration preference for either one of those two alternatives.

Mr. PICKLE. Sir, do you plead neutrality?

Mr. SVAHN. Well, now, I don't plead neutrality. I might personally be on one side or the other, but I think that what we are talking about here is a situation that has to be solved. I think that is the key thing. For Americans, we have to put the system back into balance so we can show young people today that the system is going to be there when they get ready to retire.

Mr. PICKLE. I think that is very important down to the immediate problem ahead. If you have a recommendation, we would want to know that. If you don't, we would have to proceed. I am looking for some official voice from the Administration about what you prefer.

Mr. SVAHN. At the present time, we have no recommendation, Mr. Chairman.

Mr. PICKLE. Do you have any recommendation for the notch? Have you submitted a plan by which you think we can handle the notch problem?

Mr. SVAHN. No, we have not. We are looking at that right now. We have been working with some of the committee staff on trying to ease that notch problem. We are talking about a plan that came out 2 weeks ago. We have a large bureaucracy and it takes a while to get the gears engaged and get the wheels rolling. We want to work with the committee and try to mitigate any of the administrative problems or programmatic problems that arise in any of those recommendations.

Mr. PICKLE. Once more, we are in a process of devising a plan to take care of the notch problem. If we do not hear from you, we will proceed, but we need a voice from the Administration.

Mr. SVAHN. You will hear from us, Mr. Pickle.

Mr. PICKLE. One last thing. I notice that the National Commission report commends the Social Security Administration for the issuance of tamper-proof cards. Last year you had made a proposal, rather an impromptu leak, and then you said that you were going to withdraw that and study the issue and give a recommendation to the committee on how to proceed. Have you started issuing tamper-proof cards, or is this a presumption on the part of the National Commission?

Mr. SVAHN. Well, it is a presumption on the part of the Commission. What I indicated, I think, Mr. Chairman, last year, was that before we moved forward to do that we would be up here to consult with the committee and to discuss our plans prior to any issuance or any move in that direction.

We are looking at the types of cards, what they might do. We are just in the formative stages. But we have not done it and I do remember my statement.

Mr. CONABLE. If the gentleman would yield there is a certain amount of motivation back of that commendation inasmuch as a member of the Commission, Senator Moynihan, is a great advocate of tamperproof cards.

Mr. PICKLE. Yes.

Chairman ROSTENKOWSKI. Are you studying that?

Mr. SVAHN. We are.

Chairman ROSTENKOWSKI. You are doing a study?

Mr. SVAHN. We are in the preliminary phases.

Chairman ROSTENKOWSKI. What were the estimated costs with respect to that?

Mr. CONABLE. The costs were very substantial if I recall, if you did it all at once but if you phased it in gradually, it was considerably less.

Mr. Svahn. If you did it all at once for everyone it was something like $850 million, almost $1 billion to reissue all the cards.

Chairman Rostenkowski. If you phase it in, I understand it would cost about $700 million.

Mr. Pease?

Mr. Pease. Thank you, Mr. Chairman.

Mr. Svahn, I was interested in your response to Mr. Pickle about the marriage penalty. I think we really have to go beyond your response. You pointed out that there is a fragile package here that can't be tampered with.

I understand those political difficulties but I think it is really up to this committee to decide what is politically feasible and what is not in terms of getting a package enacted on the House floor. We need to turn to you for technical advice and one thing that Members of Congress will hear about as they go back to their home districts is this so-called marriage penalty, if there is any substance to it.

In other words, if a man and wife are earning over $25,000 in income besides their social security, their social security is subject to tax, as I understand it, whereas, if that income comes to them roughly equally with two partners, then they could get divorced and they would be under the $20,000 threshold and would not have to pay taxes on their income tax.

I guarantee you we will hear about that when we go back to our districts. I think it would be helpful for the committee to have our response, if there is a response, as to why that isn't true or your recommendation for any slight modification in the Commission's recommendations which will alleviate that situation.

Well, Mr. Pease, as I said, I was not privy to the discussions that led up to the recommendation that either benefits be taxed or the levels that were set.

But I think that there were some analogies drawn to the tax code provisions regarding couples and single people drawing unemployment insurance benefits and other single and married taxpayer situations.

The marriage tax or the so-called marriage penalty is something that the Treasury Department spends a lot of time on. From that standpoint, what we are really talking about here is tax policy and I think that what we have to do is for our organization and the Treasury Department to sit down and to work with the committee in trying to figure out how it would be applied and whether or not, in fact, it is inequitable in light of all the rest of the tax policy of the U.S. Government.

I don't have any recommendations. I don't have any better numbers and, as I said, I don't know how the $20,000 and $25,000 amounts were derived. But I think it is important to recognize, Mr. Pease, that it is there. It did get the support of the President and the Speaker of the House of Representatives and the majority leader in the Senate and that is more than any other proposal that has been discussed before this committee or any other committee of the Congress has received in the past 2 years that I have been here.

Mr. **Pease**. Well, that is true. It seems doubtful to me that a change from 20 and 25 to 19 and 26 or 18 and 27 would cause the President and the Speaker to abandon their previous commitment.

So I hope that the Commission, your staff, and the IRS will at least look at that and try to give us some ammunition for when we have to respond to our constituents.

Mr. **Conable**. Will the gentleman yield? We certainly can test the compromise every way we want. The question is: How much do we want to test it? Clearly there are disadvantages in almost every element of this compromise that individuals are going to find unacceptable.

Mr. **Pease**. I don't dispute my colleague at all in that point. What I am saying is that the existence of the fragile compromise should not prevent us from at least looking at alternatives and then weighing whether they make practical sense and whether they make political sense.

Well, Mr. Svahn, just in the few seconds I have left, would you tell me when, under your timetable, your new computer capability will be in place and we won't have to worry any more about not being able to pay social security checks.

Mr. **Svahn**. Well, I can't give you a date certain. We set out a fairly comprehensive 5-year plan a year ago. We are about a year into it and in that plan we indicated that the first 18 months would basically be a survival period whereby we still are running the risk almost monthly of having problems, major problems with checks going out.

We have continuous problems with checks going to the wrong people, checks going to dead people, checks going here, checks going there, not being able to change addresses and that sort of thing.

We are seeing changes already and I think that within the next year we will be in a much, much better position than we are at the present time.

I was serious when I said that the reason we couldn't get the new assumptions up and make the runs based on the 1983 trustees report is that we had our down time on the machinery. It is an evolutionary kind of thing as opposed to one where we are going to buy a new system and it will all be in place.

But I think we are already seeing progress in that area. I look forward to continuing that in my new role.

Mr. **Pease**. Thank you.

Chairman **Rostenkowski**. Are there any further questions?

Mr. Ford?

Mr. **Ford**. Thank you very much, Mr. Chairman.

Mr. Commissioner, I want to talk very briefly about the SSI changes and the delay of the COLA on social security, the effect that it would have on the SSI recipients. The subject of the COLA, the Commission has made no recommendations as it relates to SSI. Under present law SSI recipients receive a COLA at the same time and at the same percentage as the social security COLA and with the Commission making the recommendation for the 6-month delay in the COLA, how do you interpret the Commission's report saying that it does not apply to SSI recipients but increases the disregard from $20 to $50?

Are you interpreting that to be an offset of the delay in the COLA for SSI?

Mr. Svahn. Well, I think that the National Commission's report, as you correctly indicated, recommends that the OASDI title II cost-of-living adjustment should be delayed by 6 months, and that for those persons who receive both OASDI and SSI, the dual beneficiaries, the unearned income disregard which has been $20 per month since 1974 when the SSI program first started, should be increased to $50 for title II income.

Now, I don't know what motivation went into the members of the Commission's decision to do that. At the last Commission meeting in which I was in attendance, it was pointed out that the disregard had not been raised since 1974 and the members who were there at that time—it was all but one member—just seemed to think it was a good idea.

Mr. Ford. What do you think it was designed to offset?

Mr. Svahn. Well, as I understand the history of the SSI program, the disregard of title II benefits, the $20 disregard, was put in there because it was felt that title II beneficiaries had worked for their benefits and it was different from the means-tested SSI program and that title II beneficiaries who also received SSI should get a little bit more in net income each month.

Mr. Ford. Was it designed to offset the loss of social security or SSI?

Mr. Svahn. The disregard was designed to offset social security because otherwise social security would all be deducted; it was an offset of that title II payment. You have to disregard some of the title II payment.

Mr. Ford. In other words, the 2 million of the recipients of the SSI will automatically receive a $30 increase in their SSI. But what happens to the 2 million people who are not recipients of social security?

Mr. Svahn. As I understand the recommendation of the National Commission on Social Security Reform, that increase in disregard only applies to dual beneficiaries.

Mr. Ford. That is correct. What happens to the average SSI recipient receiving $176 per month, only one income which is the supplemental security income? What happens to the 2 million who will not receive the cost-of-living adjustment, that will not receive the $30 increase in the disregards?

Mr. Svahn. Do you mean because of the delay of the OASDI cost-of-living adjustment?

Mr. Ford. If it is delayed for a period of 6 months the SSI recipients who would not be entitled to the additional $30 disregard, would not have the cost-of-living increase if we adopted the budget proposal that has been submitted by the administration because it calls for a delay also in SSI. Although the Commission did not report in their recommendations to this Congress a delay in SSI.

Mr. Svahn. I think you are talking about two separate things, Mr. Ford. The Commission recommended a delay in the title II cost-of-living adjustment and an increase in the disregard of title II payments for SSI beneficiaries who are dual beneficiaries. That is the Commission's recommendation.

Now I understand that what you are asking me is, if that is the Commission's recommendation, what about the recommendation in the budget to delay the SSI cost-of-living adjustment?

Mr. FORD. Yes. Members of the Commission who testified before the committee for the last couple of days have all indicated that the Commission did not report any language at all as it relates to a delay in SSI. But in the budget proposal we see now by the administration there is a 6-month delay also that is called for in the SSI benefits.

Now, if the disregard increased by $30 is to offset that delay under the SSI benefits, what happens with the 2 million people who are not recipients of the social security benefits in the dual program?

Mr. SVAHN. Well, I wasn't prepared today to come up and discuss the budget proposals which were made on January 31, but I can say that the delay of the SSI cost-of-living adjustment is part of a Government-wide proposal that the administration is making in the 1984 budget to delay all cost-of-living increases by 6 months.

It is not part of the National Commission's work, which recommended a delay in the cost-of-living adjustment for title II.

Mr. FORD. Well, as chairman of the Public Assistance Committee on Ways and Means we are going to send a letter to the Secretary's office and hopefully we will have someone from your office and the Secretary's office to come before the subcommittee to discuss and explain the SSI recipients who are not in the dual program, meaning social security and SSI.

Thank you, Mr. Chairman.

Chairman ROSTENKOWSKI. Thank you, Mr. Ford.

Mr. Svahn, we will have the new assumptions by Monday; won't we?

Mr. SVAHN. I think we said the 7th Mr. Chairman. I guess that is Monday.

Chairman ROSTENKOWSKI. Yes.

Mr. Gephardt?

Mr. GEPHARDT. I would like to ask you some new questions about the new medical reimbursement plan. The first question is why you decided to pass through capital costs by continuing to pay into the present system and why it was included under your new plans. Doctor, can you answer that?

Dr. RUBIN. Yes, sir, Mr. Gephardt. We acknowledge that we need to at some point in the future, include capital as part of the pricing formula under the DRG system.

Quite simply, there were a number of approaches that were suggested and none of them adequately prevented either large windfalls to hospitals based on their financing proposals or unfairly hurt several other hospitals based on their proposed financing proposals or previous commitments.

What the Department has begun as a study to look in to various alternatives to include capital within that and we are doing that in conjunction with the American Hospital Association, the Federation of American Hospitals and other interested groups.

Mr. GEPHARDT. So you don't preclude something happening in that regard at a later point?

Dr. RUBIN. Absolutely not. In fact, we are moving toward that.

Mr. GEPHARDT. The second question I would like to ask is, whether if you feel confident that, if we were to pass this legislation in the next couple of months, you are prepared to actually implement it?

I am aware of the vast complications in setting up a program if you do take into account regional differences as I assume you do, and in estabishing these categories and in actually being able to put the program in the field.

I would just like to ask if you are confident if it were passed and made the law in the country that it could be implemented in a reasonably short period of time?

Dr. RUBIN. We are confident that if we get reasonably rapid action on the part of the Congress that we could have this program up and running on October 1, 1983, for the hospitals that begin their fiscal year on that date.

As you know, under the Equity and Fiscal Responsibility Act we were using case mix or DRG bases as part of the target rate and rate of employment increase. So that some of this hardware is already in place.

We have been assured by the Health Care Finance Administration that we would be able to have this program up and running at the beginning of fiscal 1984.

Mr. GEPHARDT. The third question I understand the chairman of the committee asked earlier and that had to do with whether or not you have considered or will consider including physicians and physicians' fees in the scheme. As you are aware, I am sure, physicians have a great deal of control over costs in the medical system and my concern is if we put an elaborate hospital reimbursement program that is designed to bring hospitals in line and we don't at some point pay attention to what physicians are doing and how they are behaving and how they are setting costs in the system, that we are liable to find the hospitals lack the ability to really carry out the program and keep themselves in reasonable financial shape.

Dr. RUBIN. As you know, hospitals like to characterize themselves as laboratories in which physicians work, the implication being that they are sort of passive observers as to what we as physicians order and spend and charge to our patients.

Clearly that is not the case. Clearly what we are finding from the New Jersey experience and what common sense would tell you is that hospital administrators can work together constructively with their medical staffs to bring down costs that indeed the New Jersey experience suggests that this gives the administrator of a hospital a tool to identify physicians who have a practice pattern that is somewhat out of the norm for that community. Indeed, as recently reported in the Wall Street Journal an example is given by how the administrator exercised that authority through his administrator authority and also through the medical staff.

So we believe that administrators will work together with physicians to achieve the cost containment that one would experience under this prospective payment proposals.

Mr. GEPHARDT. But you don't reject entirely the idea that at some point you might consider applying the same system to physicians?

Dr. **Rubin**. I personally would be very happy if in 1984 we have prospective payment for hospitals for sometime in the near future.

Mr. **Gephardt**. If the chairman will allow me one additional question even though my time has expired, my last question has to do with vouchers or a voucher-like program. As you know, I have been very interested in offering the medicare recipients the option of using a set amount to be paid by the HHS or the Government to a health care plan of their choosing.

As the gentleman knows, we broadened the HMO law last year to allow this to happen with HMO's and I am very excited about that and hope that that proves beneficial for many medicare recipients.

I am wondering if the administration is considering any slight expansion of that change in the law to allow even greater use of it by other kinds of health care organizations so that as we are asking medicare recipients to enter into new arrangements under your prospective pay plan we also give them greater options to go out and purchase health care from a wider group of health care organizations.

Dr. **Rubin**. Yes, sir. The President mentioned in his state of the Union and again in his budget message as released on Monday that the administration will be sending that legislation to expand the voucher concept currently in place under TEFRA to do precisely what you described which is to offer medicare beneficiaries to choose their own plan with the Government paying 95 percent as is currently in place in TEFRA.

Mr. **Gephardt**. Thank you very much. I think it is a good two-track system.

Chairman **Rostenkowski**. Are there further questions of the witnesses?

The committee expresses its gratitude to the witnesses and this concludes the hearing.

[Whereupon, at 11:35 a.m., the hearing was adjourned.]

[**Editor's note**.—Subsequent to these hearings, the Subcommittee on Social Security held further hearings on the recommendations of the National Commission on Social Security Reform; those hearings are printed in separate volumes, Serial 98–4 and Serial 98–5. The Subcommittee on Health held hearings on the medicare hospital prospective payment system; those hearings are printed separately, Serial 98–6. Also, the Subcommittee on Public Assistance and Unemployment Compensation conducted a hearing on the effect the Commission's recommendations might have on recipients of SSI; those hearings are printed in Serial 98–7.]

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